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MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-273

AFFILIATED FUND, INC., LORD, ABBETT & CO., ROBERT S. DRISCOLL and ALVIN H. BERNDT,
Petitioners,

v.

PAULETTE PAPILSKY,
Respondent.

AFFILIATED FUND, INC., LORD, ABBETT & CO., ROBERT S. DRISCOLL and ALVIN H. BERNDT,
Petitioners,

v.

HARRY LEVINE,
Respondent.

APPENDIX

BREED, ABBOTT & MORGAN
Attorneys for Petitioner Affiliated Fund, Inc.
One Chase Manhattan Plaza
New York, New York 10005
(212) 944-4800

EDWARD J. ROSS
JAMES D. ZIRIN
Of Counsel.

DEWEY, BALLANTINE, BUSHBY, PALMER & WOOD,
Attorneys for Petitioners Lord, Abbett & Co., Robert S. Driscoll and Alvin H. Berndt
140 Broadway
New York, New York 10005
(212) 344-8000

EDWARD N. SHERRY
JUDSON A. PARSONS, JR.
Of Counsel.

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STATUTES AND RULES INVOLVED

Statutes and Rules Involved

Fed. R. Civ. P., Rule 11, 28 U.S.C. (1966):

Rule 11. Signing of Pleadings

Every pleading of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading and state his address. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. The rule in equity that the averments of an answer under oath must be overcome by the testimony of two witnesses or of one witness sustained by corroborating circumstances is abolished. The signature of an attorney constitutes a certificate by him that he has read the pleading; that to the best of his knowledge, information, and belief there is good ground to support it; and that it is not interposed for delay. If a pleading is not signed or is signed with intent to defeat the purpose of this rule, it may be stricken as sham and false and the action may proceed as though the pleading had not been served. For a wilful violation of this rule an attorney may be subjected to appropriate disciplinary action. Similar action may be taken if scandalous or indecent matter is inserted.

Fed. R. Civ. P., Rule 23.1, 28 U.S.C. (1966):

Rule 23.1. Derivative Actions by Shareholders

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or

member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

Fed. R. Civ. P., Rule 41(b), 28 U.S.C. (1966):

Rule 41. Dismissal of Actions

(b) Involuntary Dismissal: Effect Thereof. For failure of the plaintiff to prosecute or to comply with these rules or any order of court, a defendant may move for dismissal of an action or of any claim against him. After the plaintiff, in an action tried by the court without a jury, has completed the presentation of his evidence, the defendant, without waiving his right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief. The court as trier of the facts may then determine them and render judgment against the plaintiff or may decline to render any judgment until the close of all the evidence. If the court renders judgment on the merits

against the plaintiff, the court shall make findings as provided in Rule 52(a). Unless the court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule, other than a dismissal for lack of jurisdiction, for improper venue, or for failure to join a party under Rule 19, operates as an adjudication upon the merits.

Judiciary and Judicial Procedure, § 1291, 28 U.S.C. 1291 (1958):

§ 1291. Final decisions of district courts

The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the United States District Court for the District of the Canal Zone, the District Court of Guam, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court.

Sections of the Investment Company Act of 1940 as Amended, 15 U.S.C. 80a-1 et seq.

"...

2a Definitions

(3) 'Affiliated person' of another person means (A) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person; (B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person; (C) any person directly or indirectly controlling, controlled by, or under common control with, such other person; (D) any officer, director, partner, copartner, or employee of such other person; (E) if such other person is an investment company, any investment adviser thereof or any member

of an advisory board thereof; and (F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof.

"...

(9) 'Control' means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of an official position with such company.

Any person who owns beneficially, either directly or through one or more controlled companies, more than 25 per centum of the voting securities of a company shall be presumed to control such company. Any person who does not so own more than 25 per centum of the voting securities of any company shall be presumed not to control such company. A natural person shall be presumed not to be a controlled person within the meaning of this subchapter. Any such presumption may be rebutted by evidence, but except as hereinafter provided, shall continue until a determination to the contrary made by the Commission by order either on its own motion or on application by an interested person. If an application filed hereunder is not granted or denied by the Commission within sixty days after filing thereof, the determination sought by the application shall be deemed to have been temporarily granted pending final determination of the Commission thereon. The Commission, upon it own motion or upon application, may by order revoke or modify any order issued under this paragraph whenever it shall find that the determination embraced in such original order is no longer consistent with the facts.

"...

(19) 'Interested person' of another person means—

(A) when used with respect to an investment company—

(i) any affiliated person of such company,

(ii) any member of the immediate family of any natural person who is an affiliated person of such company,

(iii) any interested person of any investment adviser of or principal underwriter for such company,

(iv) any person or partner or employee of any person who at any time since the beginning of the last two fiscal years of such company has acted as legal counsel for such company,

(v) any broker or dealer registered under the Securities Exchange Act of 1934 or any affiliated person of such a broker or dealer, and

(vi) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had, at any time since the beginning of the last two fiscal years of such company, a material business or professional relationship with such company or with the principal executive officer of such company or with any other investment company having the same investment adviser or principal underwriter or with the principal executive officer of such other investment company:

Provided, That no person shall be deemed to be an interested person of an investment company solely by reason of (aa) his being a member of its board of directors or advisory board or an owner of its securities, or (bb) his membership in the immediate family of any person specified in clause (aa) of this proviso; and

(B) when used with respect to an investment adviser of or principal underwriter for any investment company—

(i) any affiliated person of such investment adviser or principal underwriter,

(ii) any member of the immediate family of any natural person who is an affiliated person of such investment adviser or principal underwriter,

(iii) any person who knowingly has any direct or indirect beneficial interest in, or who is designated as trustee, executor, or guardian of any legal interest in, any security issued either by such investment adviser or principal underwriter or by a controlling person of such investment adviser or principal underwriter,

(iv) any person or partner or employee of any person who at any time since the beginning of the last two fiscal years of such investment company has acted as legal counsel for such investment adviser or principal underwriter,

(v) any broker or dealer registered under the Securities Exchange Act of 1934 or any affiliated person of such a broker or dealer, and

(vi) any natural person whom the Commission by order shall have determined to be an interested person by reason of having had at any time since the beginning of the last two fiscal years of such investment company a material business or professional relationship with such investment adviser or principal underwriter or with the principal executive officer or any controlling person of such investment adviser or principal underwriter.

For the purposes of this paragraph (19), "member of the immediate family" means any parent, spouse of a parent, child, spouse of a child, spouse, brother, or sister, and includes step and adoptive relationships. The Commission may modify or revoke any order issued under clause (vi) of subparagraph (A) or (B) of this paragraph whenever

it finds that such order is no longer consistent with the facts. No order issued pursuant to clause (vi) of subparagraph (A) or (B) of this paragraph shall become effective until at least sixty days after the entry thereof, and no such order shall affect the status of any person for the purposes of this subchapter or for any other purpose for any period prior to the effective date of such order.

"...

10. Affiliations or interest of directors, officers, and employees

(a) No registered investment company shall have a board of directors more than 60 per centum of the members of which are persons who are interested persons of such registered company.

(b) No registered investment company shall—

(1) employ as regular broker any director, officer, or employee of such registered company, or any person of which any such director, officer, or employee is an affiliated person, unless a majority of the board of directors of such registered company shall be persons who are not such brokers or affiliated persons of any of such brokers;

(2) use as a principal underwriter of securities issued by it any director, officer, or employee of such registered company or any person of which any such director, officer, or employee is an interested person, unless a majority of the board of directors of such registered company shall be persons who are not such principal underwriters or interested persons of any of such principal underwriters; or

(3) have as director, officer, or employee any investment banker, or any affiliated person of an investment banker, unless a majority of the board of directors of

such registered company shall be persons who are not investment bankers or affiliated persons of any investment banker. For the purposes of this paragraph, a person shall not be deemed an affiliated person of an investment banker solely by reason of the fact that he is an affiliated person of a company of the character described in section 80a—12(d) (3) (A) (B) of this title.

(c) No registered investment company shall have a majority of its board of directors consisting of persons who are officers, directors, or employees of any one bank, except that, if on March 15, 1940, any registered investment company had a majority of its directors consisting of persons who are directors, officers, or employees of any one bank, such company may continue to have the same percentage of its board of directors consisting of persons who are directors, officers, or employees of such bank.

(d) Notwithstanding subsections (a) and (b) (2) of this section, a registered investment company may have a board of directors all the members of which, except one, are interested persons of the investment adviser of such company, or are officers or employees of such company, if—

(1) such investment company is an open-end company;

(2) such investment adviser is registered under subchapter II of this chapter and is engaged principally in the business of rendering investment supervisory services as defined in subchapter II;

(3) no sales load is charged on securities issued by such investment company;

(4) any premium over net asset value charged by such company upon the issuance of any such security, plus any discount from net asset value charged on re-

demption thereof, shall not in the aggregate exceed 2 per centum;

(5) no sales or promotion expenses are incurred by such registered company; but expenses incurred in complying with laws regulating the issue or sale of securities shall not be deemed sales or promotion expenses;

(6) such investment adviser is the only investment adviser to such investment company, and such investment adviser does not receive a management fee exceeding 1 per centum per annum of the value of such company's net assets averaged over the year or taken as of a definite date or dates within the year;

(7) all executive salaries and executive expenses and office rent of such investment company are paid by such investment adviser; and

(8) such investment company has only one class of securities outstanding, each unit of which has equal voting rights with every other unit.

(e) If by reason of the death, disqualification, or bona fide resignation of any director or directors, the requirements of the foregoing provisions of this section in respect of directors shall not be met by a registered investment company, the operation of such provisions shall be suspended as to such registered company for a period of thirty days if the vacancy or vacancies may be filled by action of the board of directors, and for a period of sixty days if a vote of stockholders is required to fill the vacancy or vacancies, or for such longer period as the Commission may prescribe, by rules and regulations upon its own motion or by order upon application, as not inconsistent with the protection of investors.

(f) No registered investment company shall knowingly purchase or otherwise acquire, during the existence of any underwriting or selling syndicate, any security (except a security of which such company is the issuer) a principal underwriter of which is an officer, director, member of an advisory board, investment adviser, or employee of such registered company, or is a person (other than a company of the character described in section 80a—12(d) (3) (A) and (B) of this title) of which any such officer, director, member of an advisory board, investment adviser, or employee is an affiliated person, unless in acquiring such security such registered company is itself acting as a principal underwriter for the issuer. The Commission, by rules and regulations upon its own motion or by order upon application, may conditionally or unconditionally exempt any transaction or classes of transactions from any of the provisions of this subsection, if and to the extent that such exemption is consistent with the protection of investors.

(g) In the case of a registered investment company which has an advisory board, such board, as a distinct entity, shall be subject to the same restrictions as to its membership as are imposed upon a board of directors by this section.

(h) In the case of a registered management company which is an unincorporated company not having a board of directors, the provisions of this section shall apply as follows:

(1) the provisions of subsection (a) of this section, as modified by subsection (e) of this section, shall apply to the board of directors of the depositor of such company:

(2) the provisions of subsections (b) and (c) of this section, as modified by subsection (e) of this section,

shall apply to the board of directors of the depositor and of every investment adviser of such company; and

(3) the provisions of subsection (f) of this section shall apply to purchases and other acquisitions for the account of such company of securities a principal underwriter of which is the depositor or an investment adviser of such company, or an affiliated person of such depositor or investment adviser.

"...

15. Contracts of advisers and underwriters

(a) It shall be unlawful for any person to serve or act as investment adviser of a registered investment company, except pursuant to a written contract, which contract, whether with such registered company or with an investment adviser of such registered company, has been approved by the vote of a majority of the outstanding voting securities of such registered company, and—

(1) precisely describes all compensation to be paid thereunder;

(2) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company;

(3) provides, in substance, that it may be terminated at any time, without the payment of any penalty, by the board of directors of such registered company or by vote of a majority of the outstanding voting securities of such company on not more than sixty days' written notice to the investment adviser; and

(4) provides, in substance, for its automatic termination in the event of its assignment.

(b) It shall be unlawful for any principal underwriter for a registered open-end company to offer for sale, sell, or deliver after sale any security of which such company is the issuer, except pursuant to a written contract with such company, which contract—

(1) shall continue in effect for a period more than two years from the date of its execution, only so long as such continuance is specifically approved at least annually by the board of directors or by vote of a majority of the outstanding voting securities of such company; and

(2) provides, in substance, for its automatic termination in the event of its assignment.

(c) In addition to the requirements of subsections (a) and (b) of this section, it shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral, whereby a person undertakes regularly to serve or act as investment adviser of or principal underwriter for such company, unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any such party, cast in person at a meeting called for the purpose of voting on such approval. It shall be the duty of the directors of a registered investment company to request and evaluate, and the duty of an investment adviser to such company to furnish, such information as may reasonably be necessary to evaluate the terms of any contract whereby a person undertakes regularly to serve or act as investment adviser of such company.

(d) In the case of a common-law trust of the character described in subsection (b) of section 80a—16 of this title,

either written approval by holders of a majority of the outstanding shares of beneficial interest or the vote of a majority of such outstanding shares cast in person or by proxy at a meeting called for the purpose shall for the purposes of this section be deemed the equivalent of the vote of a majority of the outstanding voting securities, and the provisions of paragraph (40) of section 80a—2(a) of this title as to a majority shall be applicable to the vote cast at such a meeting.

(e) Nothing contained in this section shall be deemed to require or contemplate any action by an advisory board of any registered company or by any of the members of such a board.

PROCEEDINGS BELOW AS TO WHICH REVIEW IS SOUGHT

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

UNITED STATES DISTRICT COURT,

SOUTHERN DISTRICT OF NEW YORK.

HARRY LEVINE, *Plaintiff*, v. ROBERT S. DRISCOLL, et al., *Defendants.*	72 Civ. 3120
PAULETTE PAPILSKY, *Plaintiff*, v. ALVIN H. BERNDT, et al., *Defendants.*	71 Civ. 2534

Before:

HON. HAROLD R. TYLER, JR.,

District Judge

New York, February 23, 1973
Room 102—3:30 p.m.

APPEARANCES:

POMERANTZ, LEVY, HAUDEK & BLOCK, Esqs.,
Attorneys for Plaintiffs,
Daniel W. Krasner, Esq., of Counsel.

MCCONNELL, SCHEUERMANN & DAVIS, Esqs.,
Attorneys for Plaintiff Harry Levine,
Wendell Davis, Jr., Esq., of Counsel.

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

DEWEY, BALLANTINE, BUSHBY, PALMER & WOOD, Esqs.,
Attorneys for Defendants,
Judson A. Parsons, Jr., Esq., of Counsel

BREED, ABBOTT & MORGAN, Esqs.,
Attorneys for Fund,
James Zirin, Esq., of Counsel.

The Court: Who speaks for the plaintiff?

Mr. Krasner: Mr. Pomerantz had to leave. He had begun something in front of another judge. He left me holding the bag.

The Court: You don't have to say a word. I have read all your papers and I am going to tell Judson Parsons unequivocally I see nothing offhand to his position whatsoever, so I have got to give him a chance to be heard.

I have read all these papers. I don't see that you have got a leg to stand on at this point. Maybe later, after we get some discovery, yes, but you know, Judson Parsons, that any district judge who will do anything like this would get his head handed to him in a matter of hours on appeal, and rightly so.

Mr. Parsons: May I hand up a reply memorandum? It was in answer to a memorandum we received yesterday.

The Court: Of course you can. What good is it going to do you? I know what you have already said.

Mr. Parsons: As you know, your Honor, we have made two motions.

The Court: Right.

Mr. Parsons: One is a motion to dismiss and the other is a motion to strike certain allegations. I want to talk first about the motion to dismiss.

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

The Court: You know that this complaint has been upheld by the appellate courts. I don't understand how in the world you can ignore that.

Mr. Parsons: There are three cases recently decided, one by Judge Pettine of the District of Rhode Island sitting in Massachusetts; one by Judge Tauro of the District of Massachusetts, and one by Judge Devitt of the District of Minnesota in the mutual fund industry, recently decided, within the last six months, that went our way and there are no contrary cases that I know of in the mutual fund industry, at least that are reported. There may be unreported ones I don't know about.

As you know, one of the cases is attached to our previous memo.

The Court: I know, but with all due respect to Messrs. Pettine, Tauro and Edward Devitt, this is not the law of our circuit and this is where we are playing the games which we call Levine versus Driscoll and Papilsky versus Berndt.

Mr. Parsons: Your Honor, I don't know of any cases in this circuit having to do with mutual funds with the statutory presumption of absence of control that have supported this kind of a pleading where the derivative suit is brought on behalf of a mutual fund.

The Court: Wouldn't you agree with me that this complaint has been upheld by Judge Wyatt and Court of Appeals and you have agreed with me before that the circuit—

Mr. Parsons: Your Honor, that motion was strictly a res judicata motion. We reserved our rights to make other motions, and the stipulations we entered into at the time.

The Court: The Court of Appeals referred to Moses v. Bergen—

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

Mr. Parsons: It is just as if this was a larceny trial. The Court of Appeals had said: Maybe if you find this guy guilty he should go to jail. There is no dealing—there was no argument whatsoever on any of these points in the Court of Appeals. It was just a pleading motion.

The Court: We have got to get the show on the road. We have been whiffling around with all these courts and I just don't think that you have got a very impressive set of arguments. Those cases may be totally meritless. I recognize that possibility. But we are not going to get in where we go granting under 11—

Mr. Parsons: 23.11.

The Court: —and 23.1.

Mr. Parsons: If you do not make an appropriate demand—you have to plead with particularity.

The Court: The plaintiffs have sued all the directors.

Mr. Parsons: In three cases that we have cited—in one of them it is very clear in the opinion—that is the one by Judge Tauro—it was people who sued, it was the directors who sued that got the case thrown out. In the other one by Judge Devitt, although it is not clear from the opinion, we checked with counsel and in that case the independent directors were named as defendants.

The Court: All right, but that isn't the law in this circuit and there are some cases in this circuit which suggest that the courts here would reach a different result.

Mr. Parsons: Your Honor, the only cases that we have found in this circuit—

The Court: Were not mutual fund cases.

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

Mr. Parsons: There is another ground for distinction too. In those there was a basis for joining those people as defendants. In this case we have done something—we have found out, plaintiff has stated to us, that is Papilsky has stated to us very clearly: This is all I have in this case. This is all the lawyers have in this case. This is all the evidence we have in this case to start this case with. That is what our affidavit is about. They have nothing to show that these unaffiliated directors should be defendants.

The Court: I believe that the courts of this circuit, including most importantly the circuit court, take a somewhat more liberal view, to use a word I hate to use, but you know what I am trying to say.

Mr. Parsons: The courts of this circuit it has been said over and over again are overwhelmed with litigation.

The Court: Don't give me that.

Mr. Parsons: It is very easy for us lawyers to say that litigation—to say: Well, we ought to have a trial and so on.

The Court: Nobody said that here, but we have not gotten these two cases off the ground. Nothing has happened really except the complaint has been filed and you have been given discovery of Mr. Pomerantz and plaintiffs and so on because you wanted to make these motions. But nothing else has happened.

Now, we all know that anybody commencing a suit like this is not going to have all of the information in the world because they are not privy to it, hence the courts in this circuit at least have taken a very dim view of the kind of motion that you are here making whether we take your motion under Rule 11 or a motion under 23.1. There just doesn't seem to

me to be any doubt about that. You may not like it, I may not like it, but that seems to be the way the game is played here.

Mr. Parsons: We have looked at the cases ourselves. We have looked at the cases cited in brief in opposition and I submit to your Honor that the cases do not hold that from this circuit and that particularly, for example, one of the cases that is relied on is the case that I think Judge Leibell decided. There it was alleged in careful detail who the directors were upon whom demand was made, where they lived, what it was they had not done, why it was they had not done it, and so on, detailed allegations with particularity.

Another case that is referred to is one of Judge Weinfeld's cases. There the claim was control. There the complaint laid it out in detail that these people—that the corporation that was a partial owner of the derivative corporation, that is of the corporation on whose behalf the suit was brought, had control of the directors and the mechanism of that was shown. None of that is involved in this case. Here we just have boiler plate allegations designed to avoid a demand rule. I submit to your Honor that the demand rule is there for a purpose and that it is for two purposes. One is for the intra-corporate remedies. It might be that the man had saved the litigation. The other is that these unaffiliated directors have a very special role in the mutual fund industry and if they decide in their undominated way that litigation should not be brought, I submit to your Honor—and they exercise a business judgment in doing that, right or wrong, I submit to your Honor that the suit should not be brought.

What we are saying here is that they should go to the independent directors and find out what their reasons are. If

they refuse a demand—maybe they won't—but assuming that they do refuse it, let's find out what their reasons are. Maybe their reasons are enough so that the case wouldn't be brought by the shareholder. I don't know. But this rule is not a pleading technicality to try to play games about drafting a pleading. It is a rule of substance as to whether courts should interject themselves into corporate affairs.

There is another thing here. This statute says it is presumed that these directors are not controlled. We have tried very hard to find anything that makes it clear what the legislative intent of that statute is, and it is unclear. There is not much of it. It seems to me perfectly clear just from looking at this statute that it is designed to make it possible for these funds to get independent directors and to give them a role to play in this business where the claim is that somehow or other the unaffiliated directors have been improperly compensated, and that is exactly the role they have in the statute and unless you can show that there is something wrong with the way they exercise judgment that is supposed to be it.

The Court: Okay. Let's here from the other side.

Mr. Krasner: I would like to turn first to Mr. Parsons' argument on demand. Mr. Parsons suggests that there are cases, and he says two cases, where directors were joined as defendants and allegations made against them and nevertheless the Court held that demand was not properly excused.

The first case is the Lerman case, your Honor, decided in Boston. In that case the opinion clearly points out, your Honor, that the directors were not directors at the time of the wrongs. They became directors at a later date.

The wrongs were committed in 1968 and all of the unaffiliated directors became directors at a later period, so they clearly could not have participated in the wrong.

In our case the independent and unaffiliated directors were all directors at the time of the wrong and they—

The Court: That is Judge Tauro's case.

Mr. Krasner: I believe that is the Lerman case.

The Court: All right.

Mr. Krasner: The second case is very unusual, your Honor. The opinion does not refer at all to any allegation in the complaint with regard to the unaffiliated directors. Instead we get a brief about an hour or half hour ago saying that they talked to the lawyers in that case and the lawyers informed them that these directors were joined as defendants. I have no idea, your Honor, whether there was any allegation in the complaint saying that because the directors were joined as defendants they need not—that demand was excused.

I would just like to point out, your Honor, that in fact there has been a demand on these directors in the form of the White litigation which we have all agreed alleges the same claims. This complaint was filed in 1968 and ultimately Mr. Parsons achieved a dismissal of this complaint on a technicality. The directors of the Fund never lifted one finger to protect the Fund and to protect the shareholders. Instead they let the case be dismissed and were it not for plaintiff Papilsky the case would have gone down the drain, despite the fact that the Court of Appeals said that this complaint alleges a good claim because it is very similar to the Moses against Bergen case, which brings me

to my final point, your Honor, on the question of demand, and that is simply this:

In the Moses against Bergen case the unaffiliated directors were ultimately exonerated because it was demonstrated that the affiliated directors had kept them in the dark about certain facts about recapture. Nevertheless, the court awarded a substantial recovery to the plaintiffs in that case and for the Fund, and then the unaffiliated directors were exonerated, so business judgment has really nothing to do with this.

The charter of the Fund here, just as the charter of the Fidelity Fund provides that if moneys can be recaptured there is a duty to recapture, so business judgment does not even come into play. The directors had a duty under the charter of the Fund to recapture and their failure to do so—

The Court: I think if I understand Mr. Judson Parsons at all, he is claiming that there are not any specific allegations in this complaint or these complaints which would satisfy the obvious policy reasons which underlie the demand and notice provisions which are the subject of Rule 23.1.

Now, as I have told him, it strikes me as being awfully technical particularly in this circuit where I have thought that it was more prudent to assume liberality more than anything else when you are dealing with 23.1 or Rule 11, for that matter, or both, as we are here. But what do you say about that? I haven't read these great cases of Judges Pettine, Devitt and Tauro, so I must say I am in the dark. I don't know.

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

Mr. Krasner: Your Honor, as I pointed out, first of all in the Kauffman case the directors were not joined as defendants, so the court using the rule up in Massachusetts, which is absolutely different from the rule in the Southern District said allegations of domination and control were not sufficient.

But here, your Honor, we have joined these directors as defendants because they participated in the wrong. They did recapture and we specifically allege that they participated in the wrong, but Mr. Parsons is a bit myopic about this and he can only see—

The Court: What he wants to see.

Mr. Krasner: —the general allegation and he does not see the specifics.

I would add, your Honor, that with respect to Rule 11 Mr. Parsons has made up allegations that didn't even appear in our complaint.

The Court: I wouldn't waste much time with Rule 11. I am not going to grant his motion under Rule 11. I can tell him and you that right now.

The only thing which I am a little puzzled about—mainly because I have never heard of these cases which he has come up with and perhaps I had better look at them, but from what you tell me so far they do not sound very impressive the way you describe them. They sounded much better the way he described them, which is usually the way, of course.

Mr. Krasner: I believe those two cases, the Kauffman and the Lerman case are distinguished in our brief.

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

The third case Mr. Parsons talked about is the one where he talked to the attorney and he put some kind of a statement in his brief about it. There is nothing in the opinion at all relating—

The Court: This is Judge Devitt's case, yes, I believe so.

Mr. Krasner: Yes, the case in Minnesota. In that case there is nothing in the opinion at all that reflects the fact that directors were joined as defendants or that there was an allegation that they participated in the wrongs and these are very specific allegations in our complaint.

The Court: I suppose I ought to look at these cases because I am not familiar with them. It strikes me that given the history of our cases here it is rather unlikely that any court should be throwing out this complaint or complaints on this kind of a showing, but you got to give the defendants every benefit of the doubt, so I will reserve decision.

I notice that two of these cases aren't officially reported. I guess they are cited in the CCH.

Mr. Parsons: One is CCH, the other I don't know if it has appeared anywhere yet. We put it in our main brief.

The Court: Yes, that is right, you did. You did indeed.

As I say, I am almost certain that I am going to deny the motion under Rule 11, but I want to think about the Rule 23.1 motion, so I will reserve a decision.

Mr. Zirin: May I just note my appearance, your Honor? I'm with Breed, Abbot & Morgan. We represent the Fund

and we wish to submit a brief memorandum setting forth our views with respect to Mr. Parsons' motion.

The Court: I take it, Mr. James Zirin that you have given all of these great men copies of this.

Mr. Zirin: Yes, we have enlightened them as well, your Honor.

The Court: All right.

Mr. Davis: My name is Wendell Davis, Jr., of the firm of McConnell, Scheuermann & Davis. We are attorneys for the plaintiff in the Levine case.

May I be heard?

The Court: Surely. You don't join with Mr. Parsons in this matter.

Mr. Davis: I do not. My position is identical with that of the Pomerantz firm, your Honor. I thought that some time could be saved if I could simply invite your Honor's attention to a particular paragraph that appears on page 7 of the decision of Judge Tauro in the Lerman case, which is the decision that is annexed to the Dewey, Ballantine brief, where Judge Tauro notes that the complaint does not charge the trustees with antagonism, adverse interest or even involvement in the 1968 externalization.

The Court: Hold on a minute. What page are we on?

Mr. Davis: Annexed to the very end there is folded into the brief—

The Court: I have got the opinion. What page?

Mr. Davis: Page 7. The page numbers are on the top of the page.

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

The Court: Okay.

Mr. Davis: This is the last full paragraph on that page.

The Court: Yes. The complaint doesn't charge the trustees.

Mr. Davis: That is right. In other words, it is a matter of pleading in the complaint involved there that the directors were not even alleged to have been involved in the transaction. That, of course, is very different from the allegations in both complaints that are involved here.

The Court: All right, yes. Well, I got that point.

Mr. Parsons: May I be heard further, your Honor?

The Court: I thought we had already heard you, but I guess we can't turn you off if you have something brief to say.

Mr. Parsons: I will be brief, your Honor. I did want to make one point about Rule 11 in spite of your Honor's feelings about that.

The Court: You have cited the cases. I told you this the other day somewhere along the line. There are very few Rule 11 cases where the relief you seek is granted and where they happen they are so far removed from this case that I just don't see the point at all.

Mr. Parsons: Your Honor, the plaintiff alleges something and you say to the plaintiff: What have you got to support that?

And the plaintiff says: Nothing.

The plaintiff alleges or if she says something that amounts to nothing like: Well, poor people tend to be

thieves and this man is poor, therefore we have got evidence that he is a thief, or something equally obscure, I think your Honor will see that he didn't have a case, that he shouldn't be in the federal court and that he shouldn't be putting people through all the bother of litigating.

The Court: With that standard a huge portion of our docket in this district would go out the window. That doesn't make any sense at all, not under Rule 11.

Mr. Parsons: Your Honor, we have both, of course, not only Rule 11. We have also the verification requirement of Rule 23.1. We submit, your Honor, that there is some test here like a probable cause test or search warrant. Otherwise every lawyer in the country just by virtue of his being a lawyer has a right to put everybody through any kind—

The Court: You just described the splendid American system to a T, no doubt about it

Mr. Parsons: I suggest to your Honor that you deplore that system just as much as I do and that this is the basis where it can be changed.

The Court: That is not the question. Whether you deplore it or I deplore it is totally beside the point. The point is that it is the system and you and I, whatever our views, are not about to change it.

Mr. Parsons: I have defied the plaintiffs by making this motion for them to find a single authority that has approached this problem from this point of view.

I submit to your Honor that it is necessary that it be dealt with or with the way litigation is multiplying these days, God help us.

Proceedings Below as to which Review is Sought

Transcript of Proceedings Before Hon. Harold R. Tyler, Jr. (February 23, 1973).

The Court: Litigation is multiplying, you are quite right, but not because of the problem you are attempting to elucidate.

Mr. Parsons: I suggest it is exactly because of that problem.

We are not talking about the summary judgment and I want to make clear that—

The Court: No, I do know the difference vaguely between Rule 56 and Rule 11.

Please do this: I don't mistake what you are saying. Please don't go out of the way to mistake what I am saying.

I am saying that there is no precise authority in any of the cases you cite for this kind of a situation at all under Rule 11. There just isn't. You know that one of the cases you cited is a case from Minnesota that has so little relation to these cases that, you know, it isn't even within artillery range of it. It really isn't. I know what was involved in that case and I know something of what is involved in this case and it just don't help.

I'm sorry I don't agree, but I'm willing to give you a little benefit of a doubt under Rule 23.1 so I am willing to reserve decision.

Thank you.

Proceedings Below as to which Review is Sought

Opinion of the District Court

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

PAULETTE PAPILSKY,

Plaintiff,

—against—

ALVIN H. BERNDT, ROBERT S. DRISCOLL, GLEN A. LLOYD, JAMES H. POTTER, PAUL W. H. TREVOR, PAUL WINDELS, JR., LORD, ABBETT & CO. and AFFILIATED FUND, INC.,

Defendants.

OPINION:
71 Civ. 2534 JXC

HARRY LEVINE,

Plaintiff,

—against—

ROBERT S. DRISCOLL, ALBERT HUGHES, JR., PAUL W. H. TREVOR, ALVIN H. BERNDT, CARL W. KNOBLOCH, GLEN A. LLOYD, JAMES H. POTTER, PAUL WINDELS, JR., LORD, ABBETT & CO., AMERICAN BUSINESS SHARES, INC., LORD ABBETT BOND-DEBENTURE FUND, INC. and AFFILIATED FUND, INC.,

Defendants.

72 Civ. 3120 HRT

POMERANTZ LEVY HAUDEK & BLOCK, Esqs.
New York City, by Abraham L. Pomerantz and Daniel W. Krasner, Esqs., Attorneys for Plaintiff Papilsky.

MCCONNELL, SCHEUERMANN & DAVIS, Esqs.
New York City, by Vincent M. McConnell, Esq., Attorneys for Plaintiff Levine.

Proceedings Below as to which Review is Sought

Opinion of The District Court

DEWEY, BALLANTINE, BUSHBY, PALMER & WOOD, ESQS.,
New York City, by Judson A. Parsons, Jr.,
Keith E. McClintock, Jr., and Patricia N. Colloton,
Esqs., Attorneys for Defendants Lord, Abbett & Co.,
Alvin H. Berndt, and Robert S. Driscoll.

BREED, ABBOTT & MORGAN, ESQS.,
New York City, by Edward J. Ross and
James D. Zirin, Esqs., Attorneys for Defendant
Affiliated Fund, Inc.

TYLER, D. J.

We have at least temporarily consolidated these two actions for the purpose of resolving the pre-trial motions discussed below. Plaintiffs are shareholders of defendant Affiliated Fund, Inc., and have brought these two actions derivatively in the Fund's behalf. Defendants are now and were the directors of the Fund during the period under challenge, its principal officers, and Lord, Abbett & Co., the Fund's investment adviser and underwriter. Put briefly, the complaints charge violations of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 et seq., the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq., and the Investment Advisers Act of 1940, 15 U.S.C. §§80b-1 et seq. These violations principally concern the manner in which the brokerage commissions generated from the Fund's trading activities were allocated: it is alleged that certain practices, among them reciprocal brokerage, give-ups and interpositioning (as they are known in the trade), redounded to the benefit of the investment adviser instead of the Fund, and that the Fund suffered consequently, and that the Fund could have recaptured some of its commissions had its directors not participated in or acquiesced in the challenged practices.

Proceedings Below as to which Review is Sought

Opinion of The District Court

The defendants in both cases have moved to dismiss the complaints, on the grounds that they do not "allege with particularity . . . the reasons for [plaintiffs'] failure to obtain the action or for not making the effort" to obtain the desired action from the directors of the company in whose name the actions are being brought. Rule 23.1, F.R.Civ.P. More specifically, defendants argue that plaintiffs' allegations of domination and control of the unaffiliated directors by the minority affiliated directors are insufficiently precise for purposes of Rule 23.1; they further contend that these allegations are without evidentiary basis, and seek to establish this by their submissions.

In general, the "particularity requirement" has as its underpinning the policy of affording the corporation every chance to bring suit in its own name, to vindicate the rights which the plaintiffs seek to uphold derivatively. The conditions excusing such demand must appear on the face of the complaint, and there is no uniform principle for deciding when the particularity requirement is met. As Professor Moore states it: "There is no unanimity of opinion amongst the courts, and probably the most straightforward approach is to admit frankly that it lies within the sound discretion of the court to determine the necessity for a demand." *3B Moore's Federal Practice* ¶ 23.1.19 at 254 (2d ed. 1969). This discretionary approach has been generally followed by the courts. See, e.g., *de Haas* v. *Empire Petroleum Company*, 435 F. 2d 1223 (10th Cir. 1970); *Herpich* v *Wallace*, 430 F. 2d 792 (5th Cir. 1970); *Fields* v. *Fidelity General Insurance Company*, 454 F.2d 682 (7th Cir. 1971).

At the same time, it can be safely stated that "[t]he courts have dispensed with demand when it is clear that the demand upon the directors would meet rejection by them." *Moore, supra* at 255. More significantly, it is the rule in this Circuit that ". . . where the directors and controlling

shareholders are antagonistic, adversely interested, *or involved in the transaction attacked,* a demand on them is presumptively futile and need not be made." *Cathedral Estates, Inc.* v. *Taft Realty Corporation,* 228 F.2d 85, 88 (2d Cir. 1955) (emphasis added). The most recent reported case on this subject in this Circuit is *Dopp* v. *American Electronic Laboratories, Inc.,* 55 F.R.D. 151 (S.D.N.Y. 1972), where Judge Weinfeld upheld a complaint under similar attack. Even more directly in point is *Liboff* v. *Wolfson,* 437 F.2d 121 (5th Cir. 1971) (per curiam). There, the complaint merely alleged that a majority of the directors "participated, approved of and acquiesced in said transactions and are liable therefor." The trial court dismissed the complaint for failure to allege with particularity plaintiff's reasons for not making a demand on the directors; on appeal, the Fifth Circuit summarily reversed, holding that the allegations cited above met the requirements of Rule 23.1, "whether or not the reasons may ultimately be found not to be fully supported." 437 F.2d at 122.

Defendants contend that a reading of the complaints here reveals nothing more than allegations that the unaffiliated directors (who comprise a majority of the board of the Fund) were under the dominion and control of the minority directors, who were partners of the management company. And, defendants rightly cite *Lerman* v. *ITB Management Corporation.* Civil Action No. 72-1363-T (D. Mass. 1973), and the many cases noted therein, for the proposition that the mere allegation of control over a majority of directors of a corporation is insufficient to meet the requirements of Rule 23.1.

But, as can be readily seen from the complaints, defendants' contention that the complaints do no more than allege control over the unaffiliated directors is a gross distortion. Although the Papilsky complaint is more precise

than the Levine complaint, both allege in substance the following: the affiliated directors (or the "Manager", as the complaint in Levine recites) control and dominate the Fund; the three affiliated directors are the principal officers of the Fund; the individual defendants are presently and were at the time of the challenged actions the directors of the Fund; "the directors participated or acquiesced in the wrongs alleged and are liable therefor" (Papilsky complaint). More than mere control is alleged; both complaints assert that this control is due to the strategic positions of the affiliated directors on the board of the Fund. Even if this were not sufficiently particular for Rule 23.1, however, it should be noted that both complaints allege that *all* directors participated in—or acquiesced in—the challenged transactions, and that they were liable therefor. This, it seems to me, brings the complaints squarely within the teachings of *Cathedral Estates* and *Liboff, supra.*

Nor can defendants find solace in Judge Tauro's opinion in the *Lerman* case, *supra.* There, the complaint asserted only that demand was not made because "those in control of the Fund are alleged wrongdoers." Moreover, only one of the five trustees of the Fund in *Lerman* was affiliated with the management company at the time of the suit; indeed, only one was trustee at the time of the challenged transactions. This, obviously, is a far cry from the complaints in the instant actions.

Defendants have erected another smokescreen by attempting to introduce voluminous documentary evidence to attack the factual basis of the complaints. Although there is no case directly on point, I think the better view is that the Rule 23.1 requirement of particularity is directed solely to the face of the complaint, and should not provide a forum for resolution of factual issues however presented. As the

Tenth Circuit observed in *de Raas* v. *Empire Petroleum Company, supra:*

> "The allegations [of the complaint] may, of course, become the subject of factual dispute (as here) but the issue remains one for the court and its determination lies within the sound discretion of the court. Courts have generally been lenient in exercising demand." 435 F.2d at 1228.

And Judge Weinfeld, in denying defendants' motion to dismiss in *Dopp* v. *American Electronic Laboratories, Inc., supra,* said:

> "These allegations, *the verity of which must be accepted on this motion,* support plaintiff's claim that any further demand upon Butler would be futile and are sufficient to comply with the pleading requirements of Rule 23.1." 55 F.R.D. at 153-4 (emphasis added).

Judge Weinfeld specifically asserts in a footnote to this passage that he did not consider the voluminous affidavits which the parties had submitted in judging the adequacy of the pleadings—although he noted that he could technically have done so, citing *DePinto* v. *Provident Security Life Insurance Company,* 323 F.2d 826 (9th Cir. 1963), *cert. denied sub nom. Garusch* v. *DePinto,* 376 U.S. 950 (1964). But in that case, the Ninth Circuit noted that it was "normal procedure" to consider only the allegations of the complaint. There were unusual circumstances, however, that led the trial court to hold a hearing: the original suit had been tried and remanded on appeal to reconstitute the parties; an intervening plaintiff sought to join the successor to the defendant fund as a party defendant; this successor in turn sought to intervene as a party plaintiff, and resisted the intervening

plaintiff's motion on the basis that no demand upon its directors had been made to intervene in the suit. The judge justifiably concluded that in this situation additional evidence would facilitate resolution of the issues. And in *Lerman, supra,* Judge Tauro received additional evidence, but again with the purpose of attempting to discern the particular reasons why plaintiff had not made demand upon the directors, since the complaint itself was obviously lacking.

Defendants have also moved to strike certain allegations from the complaints, pursuant to Rule 11, F.R.Civ.P. These allegations, according to defendants, charge them with interpositioning, with failure to obtain best executions, with failure to take full advantage of the Third and Fourth Markets, with use of give-ups after 1968, with the receipt of excessive management fees or commissions, and with improper diversion of Fund assets.

Rule 11 reads in relevant part:

> "The signature of an attorney constitutes a certification by him that he has read the pleading; that to the best of his knowledge, information and belief there is good ground to support it; and that it is not interposed for delay."

Rather than challenge the complaint in its entirety on this basis, defendants assert that plaintiffs do not have "good ground" for the allegations which are attacked, and that this warrants striking these allegations. As a basis for their motion, they have submitted the deposition of plaintiff's counsel, as well as certain other additional material.

These contentions can be disposed of briefly. First, it is not denied here by defendants that the main thrust of the

complaint, which alleges the use of "give-ups" and "reciprocals" by the Fund at the direction of the management company, states a valid claim for relief. See *Moses* v. *Burgin,* 445 F.2d 369 (1st Cir.), *cert. den. sub nom. Johnson* v. *Moses,* 404 U.S. 994 (1971); *Papilsky* v. *Berndt,* 466 F.2d 251, 254 n. 3 (2d Cir. 1972). But even assuming that Rule 11 can be so utilized to strike certain allegations within a complaint, which as a whole arguably states a claim, I cannot agree with defendants that these allegations are "sham and false and ... devoid of factual basis...." *Murchison* v. *Kirby,* 27 F.R.D. 14, 19 (S.D.N.Y. 1961). Indeed, as discussed above, defendants have sought by their characterizations of the pleadings to create a trial on paper as to the sufficiency of the evidence which plaintiffs may or may not be able to adduce, at what is essentially but the threshold of litigation.

Defendants' motions to dismiss the actions or in the alternative to strike certain allegations in the complaints are denied. In so denying these motions, I note also that defendants have neither answered the complaints nor the interrogatories of plaintiffs, even though the *Papilsky* action was commenced on June 7, 1971, and the interrogatories served more than seven months ago. Defendants must answer the complaints within fifteen (15) days and the outstanding interrogatories within thirty (30) days from the date below.

It is so ordered.

Dated: March 16, 1973

H. R. Tyler, Jr.
U.S.D.J.

Proceedings Below as to which Review is Sought

Orders of the District Court (April 16, 1973)

71 Civ. 2534

April 16, 1973

Despite the marvelous ingenuity of counsel, I find no new matters of fact and law—or such matters heretofore overlooked—as to support this motion for reargument. Rule 9(m) General Rules.

Motion for reargument considered and denied. It is so ordered.

H. R. TYLER, JR.,
U.S.D.J.

72 Civ. 3120

April 16, 1973

Despite the marvelous ingenuity of counsel, I find no new matters of fact and law—or such matters heretofore overlooked — as to support this motion for reargument. Rule 9(m) General Rules.

Motion for reargument considered and denied. It is so ordered.

H. R. TYLER, JR.,
U.S.D.J.

Proceedings Below as to which Review is Sought

Opinion of the Court of Appeals

Dkt. Nos. 73-2187, 73-2188, 73-2189, 73-2190, 73-2506, 73-2510

United States Court of Appeals

FOR THE

SECOND CIRCUIT

Dkt. Nos. 73-2188, 73-2190

PAULETTE PAPILSKY,
Plaintiff-Appellee,

v.

ALVIN H. BERNDT, ET AL.,
Defendants-Appellants.

Dkt. Nos 73-2187, 73-2189

HARRY LEVINE,
Plaintiff-Appellee,

v.

ROBERT S. DRISCOLL, ET AL.,
Defendants-Appellants.

PER CURIAM OPINION

MANSFIELD, C.J.
TIMBERS, C.J.
DAVIS, J.

[SEAL]

Proceedings Below as to which Review is Sought
Opinion of the Court of Appeals

United States Court of Appeals

FOR THE SECOND CIRCUIT

Nos. 477-482 — September Term 1973

(Argued March 11, 1974 Decided May 24, 1974)

Docket Nos. 73-2187, 73-2188, 73-2189, 73-2190,
73-2506, 73-2510

PAULETTE PAPILSKY, *Plaintiff-Appellee,* *v.* ALVIN H. BERNDT, ROBERT S. DRISCOLL, LORD, ABBETT & Co. and AFFILIATED FUND, INC., *Defendants-Appellants.*	Docket Nos. 73-2188, 73-2190 and 73-2506
HARRY LEVINE, *Plaintiff-Appellee,* *v.* ROBERT S. DRISCOLL, ALVIN H. BERNDT, LORD, ABBETT & Co. and AFFILIATED FUND, INC., *Defendants-Appellants.*	Docket Nos. 73-2187, 73-2189 and 73-2510

BEFORE:

MANSFIELD AND TIMBERS, *Circuit Judges*, AND DAVIS, *Judge.**

Appeal from an interlocutory order entered in the Southern District of New York, Harold R. Tyler, *District*

* Hon. Oscar H. Davis, of the United States Court of Claims, sitting by designation.

Proceedings Below as to which Review is Sought
Opinion of the Court of Appeals

Judge, denying motions by defendants in both actions to dismiss the complaints or to strike certain allegations from the complaints.

Dismissed for lack of appellate jurisdiction.

ABRAHAM L. POMERANTZ, New York, N. Y. (Mordecai Rosenfeld, Daniel W. Krasner and Pomerantz Levy Haudek & Block, New York, N. Y., on the brief), *for plaintiff-appellee in Nos. 73-2188 and 73-2190.*

WENDELL DAVIS, JR., New York, N. Y. (McConnell, Scheuermann & Davis, New York, N. Y., on the brief), *for plaintiff-appellee in Nos. 73-2187 and 73-2189.*

JUDSON A. PARSONS, JR., New York, N. Y. (Keith E. McClintock, Jr. and Dewey, Ballantine, Bushby, Palmer & Wood, New York, N. Y., on the brief), *for defendants-appellants Alvin H. Berndt, Robert S. Driscoll and Lord, Abbett & Co. in both actions.*

JAMES D. ZIRIN, New York, N. Y. (Edward J. Ross and Breed, Abbott & Morgan, New York, N. Y., on the brief), *for defendant-appellant Affiliated Fund, Inc. in both actions.*

PER CURIAM:

This is the second appeal from an interlocutory order that has come before us during the three year life of this litigation in the district court.

Two years ago we heard, pursuant to 28 U.S.C. § 1292(b) (1970), an appeal by defendants in the *Papilsky* action, which was commenced in June 1971, from an order of the district court denying their motion for summary judgment

on grounds of *res judicata* based on the dismissal of two prior actions that had been commenced in January 1967 and February 1968. We affirmed the order of Judge Wyatt denying summary judgment. *Papilsky v. Berndt*, 466 F. 2d 251 (2 Cir.), *cert. denied*, 409 U. S. 1077 (1972).[1]

The instant appeal, as to which a § 1292(b) certification was denied by the district court, seeks to bring up for review an interlocutory order entered on March 16, 1973 in the Southern District of New York by Harold R. Tyler, *District Judge*, denying motions by defendants in both actions to dismiss the complaints for failure to comply with the particularity requirements of Fed. R. Civ. P. 23.1, or in the alternative to strike certain allegations from the complaints pursuant to Fed. R. Civ. P. 11. We dismiss the appeal for lack of appellate jurisdiction.

The gravamen of defendants' motions below to dismiss was that the complaints do not allege with particularity the reasons for plaintiffs' failure to obtain the action they desired from the directors of the Fund or for not making the effort to obtain the desired action from the directors. Defendants argued that the allegations of domination and control of the unaffiliated directors by the minority affiliated directors are insufficiently precise for purposes of Rule 23.1. They also contended that these allegations are without evidentiary basis and sought to establish this on the instant motions by attempting to introduce voluminous documentary evidence attacking the factual basis of the complaints.

In a reasoned opinion, Judge Tyler denied the motions chiefly on the ground that plaintiffs' allegations that the unaffiliated directors were dominated by a minority of the

[1] We shall assume familiarity with the underlying allegations, particularly in the *Papilsky* action, as summarized in our prior opinion. 466 F.2d at 253.

affiliated directors, coupled with the allegations that *all* directors had participated or acquiesced in the challenged transactions, were sufficient as a matter of pleding to show the futility of a demand. The judge also refused to consider the evidence offered by defendants to show that the unaffiliated directors were not dominated.

In dismissing this appeal for lack of appellate jurisdiction, we are not aware of, and counsel have not cited us to, any case where federal appellate review of an order denying a motion addressed to the pleadings has been permitted. We believe that our decision in *Gottesman v. General Motors Corp.* 268 F. 2d 194, 196-97 (2 Cir. 1956), refusing to permit an appeal, although certified by the district court pursuant to § 1292(b), from the denial of a motion to dismiss for failure to make a demand upon stockholders, is controlling here.

Appellants place chief reliance on *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), in urging that the interlocutory order in question is appealable. Of the three requirements of *Cohen* that must be satisfied "lest this exception swallow the salutary 'final judgment rule' ", *Weight Watchers of Philadelphia, Inc.* v. *Weight Watchers International, Inc.*, 455 F.2d 770, 773 (2 Cir. 1972), we reject out of hand appellants' arguments with respect to two: the order here clearly is not one "too important to be denied review", see *Gottesman* v. *General Motors Corp., supra,* 268 F.2d at 196-97; and the delay in obtaining appellate review will not result in irreparable loss, but will simply postpone determination of the question of whether the directors under all the circumstances should have decided whether to bring the actions.

With respect to the collateral right requirement of *Cohen,* we hold that it would be stretching that doctrine

entirely too far to hold that denial of a motion to dismiss for non-compliance with the particularity requirements of Rule 23.1 is appealable. The collateral right claimed to be destroyed, i.e., the right to have the board of directors exercise its independent business judgment on whether to sue before permitting a stockholder to bring suit, is not of sufficient magnitude to permit an interlocutory appeal. In the first place, the right is not of great magnitude for the reason that, if (as might well be anticipated) a majority of the board refuses to sue, plaintiffs presumably would then be permitted to reinstitute their present action. Secondly, if plaintiffs should prevail on the merits, denial of defendants' motion to dismiss for non-compliance with Rule 23.1 would be merged in the judgment and on appeal the judgment could be set aside on the ground that plaintiffs lack standing because they failed to meet the conditions of Rule 23.1. In essence therefore the order here is not different from the ordinary order denying a defendant's motion to dismiss or for summary judgment, from which an interlocutory appeal does not lie.

Cohen and its progeny are all distinguishable because they represented denial of collateral rights which would be forever lost unless the orders were immediately reversed. In *Cohen,* for instance, the defendants, if they ultimately had prevailed on the merits, would have been unable to obtain the security for costs and attorneys' fees to which they would have been entitled prior to trial. In *MacAlister* v. *Guterma,* 263 F.2d 65 (2 Cir. 1968), and in *Garber* v. *Randell,* 477 F.2d 711 (2 Cir. 1973), which permitted appeals from the grant or denial of consolidation orders, the rights of the losing parties would have been mooted or destroyed if they had been required to comply with the district court's decision.

Finally, to the extent that appellants claim that under Rule 23.1 defendants in a derivative action have a right to a unique proceeding—something more than a motion to dismiss the complaint on its face, but something less than a full-fledged motion for summary judgment—we reject their claim as untenable. The obligation imposed by the second sentence of the Rule is neither so important nor so unique that it calls for unusual procedural mechanisms.

In view of the ground of our decision dismissing the appeal for lack of appellate jurisdiction, of course we do not reach the merits.

Dismissed.

Papilsky v. *Berndt*
Dkt. Nos. 73-2187,
73-2188, 73-2189,
73-2190, 73-2506,
73-2510 -

May 23, 1974
I Concur
WRM.

Papilsky v. *Berndt*
Dkt. Nos. 73-2187,
73-2188, 73-2189,
73-2190, 73-2506,
73-2510 -

I Concur
OHD.
May 23, 1974

Proceedings Below as to which Review is Sought

Orders of the Court of Appeals

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the sixth day of August, one thousand nine hundred and seventy-four.

Present:

HON. WALTER R. MANSFIELD
HON. WILLIAM H. TIMBERS
HON. OSCAR H. DAVIS,
Circuit Judges.

HARRY LEVINE, *Plaintiff-Appellee* *v.* ROBERT S. DRISCOLL, ALBERT HUGHES, JR., PAUL W. H. TREVOR, ALVIN H. BERNDT, CARL W. KNOBLOCH, GLEN A. LLOYD, JAMES H. POTTER, PAUL WINDELS, JR., LORD ABBETT & CO., AMERICAN BUSINESS SHARES, INC., LORD ABBETT BOND DEBENTURE FUND, INC., AFFILIATED FUND, INC., *Defendants* ROBERT S. DRISCOLL, ALVIN H. BERNDT, LORD ABBETT & CO., AFFILIATED FUND, INC., *Defendants-Appellants*	Docket No. 73-2187 73-2188-90

A petition for a rehearing having been filed herein by counsel for the appellants,

Upon consideration thereof, it is

Ordered that said petition be and hereby is DENIED.

A. DANIEL FUSARO
Clerk

by VINCENT A. CARLINO
Chief Deputy Clerk

Proceedings Below as to which Review is Sought
Orders of the Court of Appeals

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the sixth day of August, one thousand nine hundred and seventy-four.

HARRY LEVINE,

v.

Plaintiff-Appellee

ROBERT S. DRISCOLL, ALBERT HUGHES, JR., PAUL W. H. TREVOR, ALVIN H. BERNDT, CARL W. KNOBLOCH, GLEN A. LLOYD, JAMES H. POTTER, PAUL WINDELS, JR., LORD ABBETT & CO., AMERICAN BUSINESS SHARES, INC., LORD ABBETT BOND DEBENTURE FUND, INC., AFFILIATED FUND, INC.,

Defendants

ROBERT S. DRISCOLL, ALVIN H. BERNDT, LORD ABBETT & CO., AFFILIATED FUND, INC.

Defendants-Appellants

Docket No.
73-2187
73-2188-90

A petition for rehearing containing a suggestion that the action be reheard en banc having filed herein by counsel for the appellants, and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion,

Upon consideration thereof, it is

Ordered that said petition be and hereby is DENIED.

WALTER R. MANSFIELD
Acting Chief Judge

SUBSEQUENT PROCEEDINGS OF THE DISTRICT COURT RELATING IN PART TO ISSUES CONCERNING WHICH REVIEW IS SOUGHT

Subsequent Proceedings of the District Court Relating in part to Issues Concerning which Review is Sought

Opinion of the District Court

71 Civ. 2534

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

PAULETTE PAPILSKY,

Plaintiff,

against

ALVIN H. BERNDT, ROBERT S. DRISCOLL, CARL W. KNOBLOCH, GLEN A. LLOYD, JAMES H. POTTER, PAUL W. H. TREVOR, PAUL WINDELS, JR., LORD, ABBETT & CO. and AFFILIATED FUND, INC.,

Defendants.

MEMORANDUM
71 Civ.
2534 JMC

TYLER, D. J.

Defendants Paul Windels, Jr., Carl W. Knobloch, and James H. Potter have moved for an order dismissing this action against them, pursuant to Rules 41(b) and 23.1, F.R.Civ.P. Taking the Rule 41(b) motion first, the moving parties assert that the lengthy delay between the initial filing of the complaint and its service with summons upon them constitutes a lack of due diligence in the prosecution of the suit. Upon consideration of all of the circumstances, I am inclined to agree.

The docket sheet indicates that the complaint in this action was filed on June 7, 1971; the summonses for these defendants are all dated March 30, 1973, and were served on Windels on April 6, on Knobloch on April 10 and on Potter on April 19. Thus, almost two years elapsed between the initiation of the action and service upon these

defendants. In the interim, a considerable amount of litigation ensued, with several rulings by this court and the Second Circuit which might be considered adverse to these parties' interests, even though they might not be technically bound thereby.

Plaintiff responds that this failure to effectuate prompt service did not result in any prejudice to defendants, since they were all, as directors of the Fund, aware of the suit and, indeed, had collectively authorized Breed, Abbott & Morgan, Esqs. to represent the Fund and, indirectly, themselves. And she argues that dismissal with prejudice is too drastic a remedy under the circumstances, citing *Lyford* v. *Carter,* 274 F.2d 815 (2d Cir. 1960).

There is some authority for the proposition that a relatively lengthy delay in service is a sufficient ground for dismissal of an action for lack of prosecution pursuant to Rule 41(b). *Taub* v. *Hale,* 355 F.2d 201, 202 (2d Cir.), *cert. den.* 384 U.S. 1007 (1966); *Messenger* v. *United States,* 231 F.2d 328 (2d Cir. 1956); *Durst* v. *National Casualty Co.,* 452 F.2d 610 (9th Cir. 1972), *infra.* As Judge Medina asserted in *Messenger,* "The operative condition of the Rule is lack of due diligence on the part of the plaintiff—not a showing by the defendant that it will be prejudiced by a denial of its motion." 231 F.2d a 331. But it was recognized there that an order of dismissal is discretionary, and the exercise of discretion would seem to be a product of many factors—including a showing of prejudice by defendants or the demonstration of good reason for the delay by plaintiff. *Pearson* v. *Dennison,* 353 F.2d 24 (9th Cir. 1965).

The reason advanced by plaintiff why service was not made was that "almost immediately" after the commence-

ment of the action, defendants moved for dismissal, and upon losing that initial motion, moved for dismissal on other grounds. Brief of plaintiff in opposition to defendant Windels' motion to dismiss, at p. 7. And the brief continues to recite: "Due to the serious nature of these motions, plaintiff concluded that it would not serve any purpose to proliferate defendants until our right to bring this action was finally adjudicated." But the docket sheet indicates that the first motion for dismissal was filed by defendants on August 23, 1971—approximately two and one-half months after the filing of the complaint. And this concern with "proliferating" defendants is rather curious, since all three moving parties were named as defendants from the beginning.

No difficulties in service are apparent, either, which might render the delay excusable in light of *Lyford* v. *Carter, supra.* Indeed, on the designation form filed by plaintiff's counsel on June 8, 1971, the residence addresses of defendants Knobloch and Windels are listed, and the business address of defendant Potter. And, as these defendants assert in their respective affidavits accompanying their motions herein, all three regularly attended the monthly meetings of the Board of Directors of the Fund, as well as the annual stockholders meetings, with but few exceptions. In sum, what we have here is a decision, at the initiation of the suit, by plaintiff or her counsel *not* to direct the marshal to serve certain named defendants.

This apparently intentional decision not to direct service upon the moving defendants (all of whom are independent directors) is particularly troubling in a derivative action such as this, where demand upon the board of directors is required by Rule 23.1 as a matter of policy unless reasons are specified excusing such demand. Although the

undersigned ruled in a previous opinion that the complaint met the requirements of Rule 23.1 as a pleading matter, it does not follow that because demand might be excused, service might also be ignored. In sum, failure to serve any of the independent directors cannot be justified by any attempt to avoid "proliferation" of defendants, where the directors are named as defendants in a derivative action and their presence as such is virtually a prerequisite to maintaining the suit. There are also the obvious indicia of prejudice to the individual defendants themselves, who have not been able to participate in this active case over the past two years. Since they are independent directors, moreover, it cannot be said that their interests are coextensive with the other (affiliated) directors who, along with the Fund and the investment adviser, have been defending the suit.

This should suffice for the purposes of the present motion, and this court might avoid ruling on the other half of defendants' motions brought pursuant to Rule 23.1, but for the anomalous effect which this order has on the complexion of the remaining action. This court denied a similar Rule 23.1 motion brought by other defendants on March 16, 1973, ruling, in effect, that demand upon the directors was excused by virtue of the pleading that all of the defendants had "acquiesced or participated" in the alleged wrongs. But at the time of that writing, the court was ignorant of the fact that the independent directors had not yet been served with summons and complaint. Although it could be argued that the instant ruling vitiates the "reasons" adduced by plaintiff in excusing her failure to make demand, I adhere to may previous opinion, despite certain dicta in *In re Kauffman Mutual Fund Actions*, #72-1288 (1st Cir. May 14, 1973).

Subsequent Proceedings of the District Court Relating in part to Issues Concerning which Review is Sought

Opinion of the District Court

As for the attack upon the adequacy of representation, counsel for plaintiff has proceeded vigorously and ably to date, with the exception of the failure to serve the independent directors. I do not believe that this one lapse is sufficient grounds for disqualifying plaintiff at the present time.

Accordingly, this action is dismissed with prejudice against defendants Windels, Potter and Knobloch. In addition, it should be noted that defendant Lloyd was not served effectively until May 17, 1973 (prior service on April 2, 1973 was apparently withdrawn). Although Lloyd has not joined in the instant motion (since he moved to quash the second service and has just withdrawn same), the failure to prosecute is equally obvious in his case, and this action should therefore be dismissed as against Lloyd as well.

It is so ordered.

Dated: July 19, 1973

H. R. Tyler, Jr.
U. S. D. J.

Subsequent Proceedings of the District Court Relating in part to Issues Concerning which Review is Sought

Opinion of the District Court

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

HARRY LEVINE,

Plaintiff,

—against—

ROBERT S. DRISCOLL, et al.,

Defendants.

OPINION
72 Civ.
3120 HRT

McCONNELL, SCHEUERMANN & DAVIS, ESQS.,
New York City, by Wendell Davis, Jr.,
Attorneys for Plaintiff.

SKADDEN, ARPS, SLATE, MEAGHER & FLOM, ESQS.,
New York City, by Leslie H. Arps and William P. Frank, *Attorneys for Defendants Carl W. Knobloch and James H. Potter.*

WINDELS, MERRITT & INGRAHAM, ESQS.,
New York City, by Francis E. Koch,
Attorney for Defendant Paul Windels, Jr.

DEWEY, BALLATINE, BUSHBY, PALMER & WOOD, ESQS.,
New York City, by Judson A. Parsons, Jr., and Keith E. McClintock, Jr., *Attorneys for Defendants Albert R. Hughes, Jr. and Paul W. H. Trevor.*

CLEARY, GOTTLIEB, STEEN & HAMILTON, ESQS.,
New York City, by George Weisz,
Attorneys for Defendants American Business Shares, Inc. and Lord Abbett Bond-Debenture Fund Inc.

Subsequent Proceedings of the District Court Relating in part to Issues Concerning which Review is Sought

Opinion of the District Court

TYLER, D.J.

Various defendants have moved to dismiss this action pursuant to Rules 12(b), 23.1 and 41(b) of the Federal Rules of Civil Procedure.[1] Familiarity with the facts will be assumed since the courts have already decided prior motions in this case and in related cases. *Papilsky* v. *Berndt*, 466 F.2d 251 (2d Cir.), *cert. denied*, 409 U.S. 1077 (1972); *Papilsky* v. *Berndt*, 59 F.R.D. 95 (S.D.N.Y. 1973); *Papilsky* v. *Berndt*, Civil No. 71-2534 (S.D.N.Y., filed July 20, 1973).[2] For the reasons hereinafter stated, defendants' motions to dismiss pursuant to F.R.Civ.P. 41(b) are granted. In addition, the case against defendants American Business Shares, Inc. ("ABS") and Lord Abbett Bond-Debenture Fund Inc. ("the Fund") is also dismissed for failure to state a claim upon which relief can be granted. Rules 12(b)(6) and 56, F.R.Civ.P.

Defendant Windels has urged this court to dismiss pursuant to F.R.Civ.P. 12(b)(6). In the related case of *Papilsky*, Civil No. 71-2534, the action against defendants Windels, Knobloch and Potter was dismissed pursuant to F.R.Civ.P. 41(b). This court found there that the "lengthy delay between the filing of the complaint and its service with summons amounted to a lack of diligence in the prosecution of the suit." It is argued that that decision should operate as a bar to the present action on the grounds of *res judicata*. It is true that the instant complaint is essentially identical to the one asserted in *Papilsky*, the only

[1] Not all defendants have joined in all these motions.

[2] These decisions will be referred to hereinafter as *Papilsky*. In order to distinguish them, an abbreviated citation will be given each time. The underlying case will be referred to as *Papilsky* with no citation.

difference being that this derivative suit is brought by a different plaintiff. Nevertheless, this court must deny the motion for the reasons stated by the Court of Appeals in *Papilsky,* 466 F.2d 251.

There a similar motion was made seeking *res judicata* effect for a prior related suit, *White and Bernstein* v. *Driscoll,* Civil No. 67-98 (S.D.N.Y., filed Dec. 9, 1968). Judge Timbers, writing for the appellate court, held that:

> " . . . when notice of a proposed dismissal of a stockholder's derivative suit for failure to answer interrogatories is not given to non-party stockholders, the judgment of dismissal does not bar an identical cause of action asserted by a different stockholder in a subsequent derivative suit." *Id. at* 256.

Although this court dismissed the action in *Papilsky* v. *Berndt,* Civil No. 71-2534, for lack of diligence in prosecuting rather than for failure to answer interrogatories, the court in *Papilsky,* 466 F.2d 251, recognized that a dismissal for failure to prosecute should have the same effect as a dismissal for failure to answer interrogatories. *Id.* n. 5 at 256. This court's decision in *Papilsky,* Civil No. 71-2534, will not therefore be given *res judicata* effect.

Defendants Windels, Knobloch, Potter, Hughes and Trevor have moved to dismiss this action under F.R.Civ.P. 23.1, alleging that plaintiff had failed to make a demand on the board of directors before commencing this suit, and that plaintiff has shown no excuse for such failure. This court has denied a similar Rule 23.1 motion brought by other defendants in this case, *Papilsky* v. *Berndt,* 59 F.R.D. 95[3] and denied the Rule 23.1 motion of Windels, Knobloch

[3] *Levine v. Driscoll* was consolidated with *Papilsky v. Berndt* for the purposes of that F.R.Civ. P 23.1 motion.

and Potter in *Papilsky,* Civil No. 71-2534. For the reasons stated in those decisions, defendants' motions under Rule 23.1 must be denied.

Defendant Windels has also moved to dismiss, again under Rule 23.1, on other grounds. This motion is denied. First under this motion, Windels argues that dismissal should be warranted by the failure of plaintiff to verify his complaint. In a non-frivolous case such as this one, it has been held by at least one circuit court that the verification of the complaint upon information and belief by plaintiff's attorney is sufficient. *Hirshfield* v. *Briskin,* 447 F. 2d 694, 698 (7th Cir. 1971). As was pointed out by the Supreme Court in a somewhat analogous case, "[t]he basic purpose of the Federal Rules is to administer justice through fair trials, not through summary dismissals as necessary as they may be on occasion." *Surowitz* v. *Hilton Hotels Corp.,* 383 U.S. 363, 373 (1966). Accordingly, this court will not grant the motion on this basis. Nevertheless, it is difficult to ignore the plain language of Rule 23.1 in this regard. Hence, this ruling is conditioned upon a direction that plaintiff submit a verification of his complaint within 10 days of the filing of this opinion. In light of this provision, Windels' argument that plaintiff's failure to verify the complaint makes him an unfit representative of the shareholders is no longer relevant.

The other base for Windels' motion under Rule 23.1 appears to come down to the argument that the fact that plaintiff did not promptly effect service on certain defendants is an indication that he is unable to properly represent the interest of the shareholders in this litigation —i.e. that his failure through his counsel to effect prompt service is sufficient by itself to disqualify him. Though

ingenious, this argument, in my view, is insufficient. The failure to effect prompt service on certain defendants admittedly is a problem and will have adverse effects, but it certainly is not a sufficient reason for dismissal under the particular rule invoked by defendant Windels, particularly when it is not at all clear but that the failure may have been due not to plaintiff but his counsel. See *Papilsky* v. *Berndt*, Civil No. 71-2534.

Defendants ABS and the Fund have moved this court, pursuant to F.R.Civ.P. 23.1, to dismiss this action against them on the ground that plaintiff has no standing to bring a derivative action on their behalf. Their motion is based on the fact that plaintiff was not a shareholder of those companies at the time of the transactions of which he complains. Plaintiff, however, conceding that he is not suing derivatively for them in the classic sense, argued that ABS and the Fund are properly joined as defendants in this action for other reasons. He has alleged no wrong doing on the part of these two defendants but complains that Lord, Abbett & Co., the manager of Affiliated Fund, Inc. ("Affiliated") has used advantages which it secured as manager for the benefit of defendants ABS and the Fund. Plaintiff's complaint § 19. Plaintiff has also stated that the fees charged Affiliated by Lord, Abett & Co. were excessive and that if the asset values of ABS and the Fund had been added to the assets of Affiliated, the fees charged by Lord, Abbett & Co. would have been reduced. Plaintiff argues that Affiliated has a right, therefore, to have those fees recomputed and that ABS and the Fund share in that right. Plaintiff's complaint § 23.

The joinder of ABS and the Fund is not necessary to enable this court to decide whether the fees charged Affili-

ated by Lord, Abbett & Co. should be recomputed. Since no claim is asserted against ABS or the Fund, plaintiff has failed to state a claim upon which relief can be granted and his cause of action as to these two defendants must be dismissed pursuant to Rules 12(b)(6) and 56, F.R.Civ.P.[4]

All defendants presently moving have asked this court to dismiss plaintiff's action, pursuant to F.R.Civ.P. 41(b), for failure of the plaintiff to prosecute. More specifically, moving defendants focus their attack upon the lengthy delay in the service of the complaint with summons on them. The compaint in this action was filed on July 21, 1972. Service on Knobloch was made on August 13, 1973, and on all the other moving defendants four days earlier on August 9, 1973.[5]

[4] In their motion papers defendants ABS and the Fund did not move to dismiss pursuant to Rules 12(b)(6) or 56. In their brief, however, and in oral argument they did argue that the complaint should be dismissed as to them pursuant to Rule 12(b)(6). Plaintiff has also addressed his arguments to this issue. This court therefore does not hesitate to dismiss on this ground. Cf. *Dodd v. Spokane County*, 393 F. 2d 330, 334 (9th Cir. 1968).

[5] Plaintiff claims that defendants Trevor, ABS and the Fund were served in July, 1972. On August 14, 1972, however, it was stipulated that the attempt to serve Trevor was "null and void" and it was so ordered by this court on August 29, 1972. Since plaintiff's action against ABS and the Fund has already been dismissed, the date of their service is not really important. Plaintiff claims that service on the officers, directors or managing agent of these defendants is enough to constitute service on the two corporations. It should be noted, however, that the directors, officers and managing agent were served in their individual rather than their representative capacity. While it is true that ABS and the Fund may have had practical notice of this suit, they also may have justifiably assumed that plaintiff had decided not to bring them into this case. The July, 1972 service of others, therefore, should not be considered proper service upon them. Cf. *Sunbeam Corporation v. Windsor-Fifth Avenue*, 124 F. Supp. 547 (S.D.N.Y. 1954); *Port Chester Electrical Company v. Ronbed Corporation*, 28 App. Div. 2d 1008, 284 N.Y.S. 2d 9 (2d Dept. 1967).

Subsequent Proceedings of the District Court Relating in part to Issues Concerning which Review is Sought

Opinion of the District Court

In support of their 41(b) motions, defendants rely on the related case of *Papilsky,* Civil No. 71-2534, in which this court dismissed the complaint against defendants Windels, Knobloch and Potter because of a delay of almost two years in service. Plaintiff in that case had unsuccessfully argued against dismissal on the grounds that the moving defendants were aware of the suit and had collectively authorized Breed, Abbott & Morgan, Esqs. to directly represent Affiliated and indirectly themselves. Plaintiff here seeks to distinguish *Papilsky,* Civil No. 71-2534, on the grounds that there was nine months less delay in the instant case and that the intervening proceedings here were not dispositive of any of the rights of the moving defendants.

Before the summons and complaint had been served on movants in *Papilsky,* Civil No. 71-2534, the following events had occurred: a motion for summary judgment; an appeal from its denial; a petition for certiorari; and an examination before trial. It should be noted that in the instant case, on September 14, 1972, plaintiff and the defendants who were served in July, 1972, in this (*Levine*) action stipulated that they would be bound by the proceedings concerning the motion for summary judgment in the *Papilsky* case. Furthermore, on February 5, 1973, the served defendants in *Levine* joined the served defendants in *Papilsky* and moved unsuccessfully to dismiss the complaint or strike certain allegations contained therein. In *Papilsky,* the served defendants responded to two series of interrogatories; in the instant action, the served defendants have filed responses to plaintiff's first request for admissions.

It would seem, therefore, that the moving defendants here have been just as prejudiced as those in *Papilsky,* Civil No. 71-2534, and that the single distinction of less

delay in months is not a real difference.[6] Although the focus in the Second Circuit has been on lack of due diligence rather than on prejudice to the defendant, it has been recognized that the prejudice to the defendant and the lack of any good reason for delay are proper factors to be considered. *Messenger* v. *United States,* 231 F.2d 328, 331 (2nd Cir. 1956).

For the reasons set forth by this court in *Papilsky,* Civil No. 71-2534, defendants' motions to dismiss pursuant to F.R.Civ.P. 41(b) for failure to prosecute are granted, and the action shall be dismissed against these defendants. Settle order accordingly on notice.

Dated: January 7th, 1974

H. R. Tyler, Jr.
U.S.D.J.

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[6] It is true that Trevor and Hughes do not seem to be "independent directors". It has not been shown, however, that their interests are necessarily coextensive with those of the other affiliated directors. Moreover, a delay of some thirteen months is of itself sufficient to warrant dismissal in this case.

PREVIOUS OPINIONS IN THE CASE ON ISSUES NOT RELEVANT TO THE PETITION

Previous Opinions in the Case on Issues not Relevant to the Petition

Opinion of the District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

PAULETTE PAPILSKY,
Plaintiff,
—against—
ALVIN H. BERNDT, ROBERT S. DRISCOLL, CARL W. KNOBLOCH, GLEN A. LLOYD, JAMES H. POTTER, PAUL W. H. TREVOR, PAUL WINDELS, JR., LORD, ABBETT & CO. and AFFILIATED FUND, INC.,
Defendants.
71 Civ. 2534

APPEARANCES:

MORDECAI ROSENFELD, ESQ.
Attorney for Plaintiff
233 Broadway
New York, New York 10007

POMERANTZ LEVY HAUDEK & BLOCK, ESQS.,
Counsel to Plaintiff
295 Madison Avenue
New York, New York 10017

ABRAHAM L. POMERANTZ, ESQ.
MORDECAI ROSENFELD, ESQ.
DANIEL W. KRASNER, ESQ.
Of Counsel

DEWEY, BALLANTINE, BUSHBY, PALMER & WOOD, ESQS.,
Attorneys for Defendants Lord, Abbett & Co., Alvin H. Berndt and Robert S. Driscoll
140 Broadway
New York, New York 10005

JUDSON A. PARSONS, JR., ESQ.
GERALD E. ROSS, ESQ.
Of Counsel

Previous Opinions in the Case on Issues not Relevant to the Petition

Opinion of the District Court

WYATT, District Judge,

This is a motion by three of the named defendants—Lord, Abbett & Co., Alvin H. Berndt and Robert S. Driscoll—for summary judgment in their favor. Fed. R. Civ. P. 56(c)

The action was commenced on June 7, 1971. Plaintiff brings the action as the owner of stock of defendant Affiliated Fund, Inc. (Fund), a Delaware corporation, and the action is a derivative one to enforce a right of Fund. Fed. R. Civ. P. 23.1

Fund is an open-end diversified investment company, said to be registered under the Investment Company Act of 1940 (15 U.S.C. § 80a-1 and following). Lord, Abbett & Co. (Lord) is a partnership. Berndt and Driscoll are partners of Lord and are officers and directors of Fund. Lord is employed by Fund as investment manager of Fund under an agreement.

The claim asserted in the case at bar is that Lord, in connection with transactions for Fund, uses "reciprocal brokerage, give-ups and interpositioning" and has received additional compensation by so doing. It is moreover charged that Lord, by its use of such techniques, has paid dealers which sell shares of Fund to the public and that Lord has been thus relieved of the necessity to compensate such dealers.

Fund, it is claimed, has been damaged because the use of reciprocal brokerage, give-ups and interpositioning has resulted in excessive compensation to Lord. Demand is made that Lord and the individual defendants pay $6,000,000 in damages to Fund.

On January 10, 1967, Vera G. White commenced an action in this Court (67 Civ. 98) against all the defendants

in the case at bar and other defendants not named in the case at bar.

On March 28, 1968, Anne Bernstein commenced an action in this Court (68 Civ. 1252) against all the defendants in the case at bar and other defendants not named in the case at bar.

By order filed August 30, 1968, the White and Bernstein actions were consolidated. Plaintiffs thereafter served a "consolidated complaint" which was filed on September 26, 1968. The consolidated action will be referred to as the "White action".

Fund was a defendant in the White action but was the nominal defendant for whose benefit the action was brought. Fund was represented by separate counsel who represented only Fund in the White action.

It is undisputed that the claims in the White action are the same as those now asserted in the case at bar.

By order in the White action filed on January 14, 1969, plaintiffs were directed to answer certain interrogatories served by defendants. Plaintiffs White and Bernstein did not answer the interrogatories.

In the White action and on February 3, 1971, defendants Lord, Driscoll and Trevor obtained an order that "the *plaintiffs* show cause" (emphasis supplied) why the action should not be dismissed for failure to answer the interrogatories. The order to show cause was returnable on February 11, 1971, and it is assumed that a copy of the order was served on counsel for Fund.

In the White action, defendants Johnston, Knoblock, and James H. Potter by notice of motion brought on a motion to dismiss the action for the same reason, failure of plaintiffs to answer the interrogatories. The notice of motion was addressed, among others, to counsel for Fund.

Previous Opinions in the Case on Issues not Relevant to the Petition

Opinion of the District Court

The two motions—one made by order and one by notice —were heard by me on February 11, 1971. Fund took no position on these motions and submitted no papers.

The two motions were referred to Honorable Gregory J. Potter as Special Master. The report of the Special Master was dated March 4, 1971, and advised that the White action be dismissed for failure to answer the interrogatories. The Special Master concluded that plaintiffs "are not serious in prosecuting this action".

The motions were then granted by me and the Clerk was directed to enter judgment dismissing the White action as to the moving defendants. Judgment, filed on March 22, 1971, was that the moving defendants "have judgment against plaintiff Anne Bernstein dismissing the complaint as to the said defendants only". By order filed March 31, 1971, the decretal paragraph of the judgment was amended "to include plaintiff Vera G. White".

It appears that outside of the moving defendants, the only defendant served in the White action was Fund, the nominal defendant for whose benefit the action was brought.

The White action remained pending against Fund, the nominal defendant, and no other defendants were served after the judgment of dismissal as to the moving defendants.

The White action was called by the Chief Judge on the Review Calendar on December 8, 1970 and plaintiffs were given until May 14, 1971 to file a note of issue for trial, etc. By order filed June 14, 1971, the Chief Judge dismissed the action "for lack of prosecution, without prejudice and without costs".

The question on the present motion in the case at bar is whether the judgment in the White action was an "adjudication on the mertis" (Fed. R. Civ. P. 41(b)) so as to

bar the present claim. This question is not without difficulty. No decision on the precise point has been cited by counsel and none has been turned up by independent research.

The conclusion I reach is that dismissal of the White action was not an "adjudication on the merits" of the claim of Fund and that the present motion must be denied. On the other hand, granting the motion would end the litigation. The situation thus seems appropriate for review by the Court of Appeals under 28 U.S.C. § 1292(b).

Preliminarily it should be noted that in the White action there was no "notice of the proposed dismissal" to shareholders. Fed. R. Civ. P. 23.1. Probably this was because counsel then concerned believed that the cited Rule was not applicable; possibly it was due to inadvertence.

By its wording, Rule 23.1 requires notice of *any* dismissal. There are no exceptions.

Able counsel for movants argue that notice is required only for "voluntary" dismissals. There is language in at least one case which gives some support to this view. Some support is found in *Hutchinson* v. *Fidelity Inv. Ass'n*, 106 F.2d 431, 436 (4th Cir. 1939) but in that case the action was dismissed "after hearing on the merits" (106 F.2d at 436). A law review author has flatly stated that the notice requirement "applies only to voluntary, not to involuntary dismissals". Simeone, Procedural Problems of Class Suits, 60 Mich. L. Rev. 903, 934 (1962). Judge Tenney has held that notice is not required where dismissal is for lack of jurisdiction over the person. *Marcus* v. *Textile Banking Corp.*, 38 F.R.D. 185 (S.D.N.Y. 1965). In *Daugherty* v. *Ball*, 43 F.R.D. 329, 334-336 (C.D.Cal. 1967) the question is discussed in respect of dismissals on the merits.

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There are good reasons for not requiring notice when dismissal is on the merits. In such a case, there is a judicial determination that the real defendants are not liable. When, however, the dismissal is for some reason personal to plaintiff and there is no judicial exoneration of the real defendants, there is less reason for dispensing with notice. An example of such a situation is seen in *Saylor* v. *Lindsley,* 391 F.2d 965 (2d Cir. 1968) where plaintiff in an earlier action failed to post a required bond and there was dismissal of that action; it was not discussed whether notice should have been given.

I am inclined to believe that notice to shareholders was required in connection with dismissal of the White action. For purposes of the present motion, however, it will be assumed that no notice was required.

Analysis of the nature of a derivative suit by a stockholder shows that dismissal of the White action does not bar the present action.

The derivative suit contains two claims: (1) a claim by the corporation in which plaintiff is a stockholder, and (2) a claim by the stockholder against his corporation for its failure to enforce the claim belonging to it ((1) above). Ballantine, Private Corporations, 612

This analysis was made by the Supreme Court last year in *Ross* v. *Bernhard,* 396 U.S. 531, which dealt with the right to a jury trial in derivative actions. The Supreme Court said (396 U.S. at 534-5):

> "As elaborated in the cases, one precondition for the suit was a valid claim on which the corporation could have sued, another was that the corporation itself had refused to proceed after suitable demand, unless excused by extraordinary conditions. Thus the dual

> nature of the stockholder's action: first, the plaintiff's right to sue on behalf of the corporation and, second, the merits of the corporation claim itself."

and again (396 U.S. at 538):

> "We have noted that the derivative suit has dual aspects: first, the stockholder's right to sue on behalf of the corporation, historically an equitable matter; second, the claim of the corporation against directors or third parties on which, if the corporation had sued and the claim presented legal issues, the company could demand a jury trial."

The policy and purpose of Rule 41(b) is accomplished by giving effect to the dismissal of the White action as an "adjudication upon the merits" of the claim of the White plaintiffs against Fund, that is to say, their claim to sue on behalf of Fund. There is a reluctance, however, to treat that dismissal as adjudicating the second aspect of the claim in the White action, that is, the claim of Fund against the other defendants. That claim has never been heard on its merits (and of course no opinion is here implied that it has, or has not, any merit). Fund took no part in the motions to dismiss in the White action. That action was not dismissed as to Fund until Chief Judge Sugarman entered his order of dismissal and that order was "without prejudice".

A further policy consideration may be noted. There is not the slightest suggestion of any impropriety in the motions to dismiss and in the dismissal of the White action; the Court at the time was fully advised in the premises. Nevertheless, a rule which would permit such a dismissal to bar the claim of the corporation beneficiary would in some future time afford opportunities for collusion

in procuring the dismissal of derivative actions. For a thoughtful discussion of a somewhat similar problem involving class actions, see Judge Decker's opinion in *Yaffe* v. *Detroit Steel Corp.*, 50 F.R.D. 481 (N.D. Ill. 1970).

Careful attention has been paid to *Costello* v. *United States*, 365 U.S. 265 (1961). The Supreme Court there discussed Rule 41(b) and emphasized that dismissals which are "adjudications upon the merits" under that Rule are primarily those involving "situations in which the defendant must incur the inconvenience of preparing to meet the merits because there is no initial bar to the Court's reaching them" (365 U.S. at 286). I am prepared to assume that such was the situation in the White action; the movants show an impressive amount of preparation by them in that action. The decision on the present motion is not that Rule 41(b) does not apply. On the contrary, Rule 41(b) does apply and its application bars the claim which belonged to the White plaintiffs. Rule 41(b), however, does not require that the claim be barred which belonged to Fund.

For the reasons indicated, the motion is denied.

I am of the opinion that this order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation. 28 U.S.C. § 1292(b)

So Ordered.

Dated: New York, New York
November 17, 1971

INZER B. WYATT
United States District Judge

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

• • •

No. 759—September Term, 1971.

(Argued May 24, 1972 Decided August 1, 1972.)

Docket No. 72-1052

• • •

PAULETTE PAPILSKY,

Plaintiff-Appellee,

v.

ALVIN H. BERNDT, ROBERT S. DRISCOLL and LORD, ABBETT & Co.,

Defendants-Appellants,

and

CARL W. KNOBLOCH, GLEN A. LLOYD; JAMES H. POTTER, PAUL W. H. TREVOR, PAUL WINDELS, JR. and AFFILIATED FUND, INC.,

Defendants.

• • •

Before:

LEVENTHAL,* FEINBERG and TIMBERS,

Circuit Judges.

• • •

Appeal pursuant to 28 U.S.C. § 1292(b) (1970) from an order of the District Court for the Southern District of New York, Inzer B. Wyatt, *District Judge,* 333 F.Supp.

* Of the United States Court of Appeals for the District of Columbia Circuit, sitting by designation.

1084, denying defendants' motion for summary judgment based on *res judicata*.

Affirmed.

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ABRAHAM L. POMERANTZ, New York, N.Y. (Mordecai Rosenfeld, William E. Haudek, Daniel W. Krasner and Pomerantz, Levy, Haudek & Block, New York, N.Y., on the brief), *for plaintiff-appellee.*

JUDSON A. PARSONS, JR., New York, N.Y. (Hugh N. Fryer, Keith E. McClintock, Jr., Patricia A. Nelson and Dewey, Ballantine, Bushby, Palmer & Wood, New York, N.Y., on the brief), *for defendants-appellants.*

• • •

TIMBERS, *Circuit Judge*:

The essential issue on this appeal is whether dismissal of a stockholder's derivative suit, without notice to non-party stockholders, under Fed. R. Civ. P. 37(b)(2)(C), for failure to answer interrogatories, operates as a bar to an identical cause of action asserted by another stockholder in a subsequent derivative suit.

Plaintiff Paulette Papilsky is a shareholder of defendant Affiliated Fund, Inc. and brought this action derivatively on behalf of Affiliated, a diversified open-end investment company registered under the Investment Company Act of 1940. Defendant Lord, Abbett & Co. serves as Affiliated's investment adviser and as its principal underwriter. Defendants Driscoll and Berndt are partners in Lord, Abbett and officers and directors of Affiliated. Papilsky's complaint alleged that these defendants failed to recapture, and to credit Affiliated with, allegedly re-

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capturable portions of brokerage commissions paid on portfolio transactions and asserted that this has resulted in the payment of higher management fees to Lord, Abbett, all in violation of the federal securities laws.[1] Shortly after the complaint was served, defendants Driscoll, Berndt and Lord, Abbett served and filed a motion seeking summary judgment on the ground of *res judicata*. They alleged that the claims asserted by Papilsky were identical to those asserted in a previous derivative suit against Driscoll, Berndt, Lord, Abbett and other defendants entitled *White and Bernstein* v. *Driscoll, et al.*, S.D.N.Y. 67 Civ. 98 (the "*White* action"), which had been dismissed for failure to answer interrogatories. Judge Wyatt on November 17, 1971 denied defendants' motion for summary judgment, 333 F. Supp. 1084, but granted the necessary certification to appeal pursuant to 28 U.S.C. § 1292(b) (1970), as did we on December 6, 1971. For the reasons stated below, we affirm the denial of the motion for summary judgment.

I.

The *White* action was a consolidation of two separate stockholders' derivative actions, the first commenced in January of 1967 and the second in February of 1968. As the district court found, "[i]t is undisputed that the claims in the White action are the same as those now asserted in the case at bar." 333 F. Supp. at 1085. There is no suggestion, however, that the *White* plaintiffs or their attorneys are in any way connected with the instant case.

[1] §§ 1(b)(2), 2(a)(3), 2(a)(9), 10, 15, 17(e), (h) and (i), 36 and 37 of the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1(b)(2), 80a-2(a)(3), 80a-2(a)(9), 80a-10, 80a-15, 80a-17(e), (h) and (i), 80a-36 and 80a-37 (1970); §§ 10(b) and 15(c)(1) and (2) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j and 78o(c)(1) and (2) (1970); and § 206(4) of the Investment Advisers Act of 1940, 15 U.S.C. § 80b-6(4) (1970).

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On January 14, 1969, the district court entered orders directing the *White* plaintiffs to answer interrogatories on February 15, 1969, which date was extended to March 4, 1969. The interrogatories ordered to be answered requested the *White* plaintiffs to specify the claimed violations of law and sought details as to each claimed violation. On March 31, 1970, more than a year after the deadline for answering the interrogatories, the *White* plaintiffs filed their answers. The defendants considered these unsigned and unverified answers to be unacceptable and returned them to plaintiffs. Threafter, on December 10, 1970, the *White* plaintiffs served by mail purported answers to the interrogatories. The defendants also found these responses to be inadequate.

On February 3, 1971, the *White* defendants brought on by order to show cause a motion pursuant to Fed. R. Civ. P. 37(b)(2)(C) seeking dismissal of the action on the ground of the plaintiffs' failure to answer the interrogatories as required by the district court's order of January 14, 1969.[2] The *White* plaintiffs opposed the granting of this motion.

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[2] Fed. R. Civ. P. 37(b)(2)(C) provides as follows:

"If a party or an officer, director, or managing agent of a party or a person designated under Rule 30(b)(6) or 31(a) to testify on behalf of a party fails to obey an order to provide or permit discovery, including an order made under subdivision (a) of this rule or Rule 35, the court in which the action is pending may make such orders in regard to the failure as are just, and among others the following:

* * *

(C) An order striking out pleadings or parts thereof, or staying further proceedings until the order is obeyed, or dismissing the action or proceeding or any part thereof, or rendering a judgment by default against the disobedient party."

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Judge Wyatt referred the motion to a Special Master. The Master concluded that plaintiffs' long delayed answers to the interrogatories were "totally inadequate" and that "[t]he deficiency of the answers to interrogatories and the delay in serving them demonstrates that plaintiffs are not serious in prosecuting this action." Accordingly, the Master recommended that the *White* action be dismissed.

In March 16, 1971, Judge Wyatt entered an order granting defendants' motion and dismissing the action as to all defendants served other than the nominal defendant, Affiliated. Notice of the dismissal was not given to nonparty stockholders. On March 22, 1971, a judgment was entered dismissing the action as to the moving defendants, which judgment was amended by endorsement on March 30, 1971 to include both plaintiffs. Neither the judgment nor the orders provided that the dismissal was without prejudice.

As a result of the judgment, there continued pending on the district court's docket a derivative action in which Affiliated, the nominal defendant, was the only remaining defendant which had been served. On June 12, 1971, Chief Judge Sugarman entered a routine calendar order of dismissal, stated to be without prejudice.

Plaintiff Papilsky filed her complaint in the instant action on June 7, 1971.[3]

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[3] On June 4, 1971, three days before Papilsky filed her complaint, the First Circuit held that claims similar to those asserted in Papilsky's complaint did constitute violations of the Investment Company Act of 1940. *Moses* v. *Burgin*, 445 F.2d 369 (1 Cir.), *cert. denied sub nom. Johnson* v. *Moses*, 404 U.S. 994 (1971). The First Circuit thereby reversed in part a district court judgment of August 18, 1970 which had dismissed on the merits a derivative suit brought on behalf of a mutual fund involving claims similar to those asserted in *White*. *Moses* v. *Burgin*, 316 F.Supp. 31 (D. Mass. 1970). In opposing the *White* defendants' motion for dismissal pursuant to Rule 37(b)(2)(C), the *White* plaintiffs tried to excuse their delay in

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II.

It is now well established that Fed. R. Civ. P. 41(b) states the effect to be accorded a dismissal under Fed. R. Civ. P. 37.[4] *Stebbins* v. *State Farm Mutual Automobile Insurance Co.*, 413 F.2d 1100, 1102 (D.C. Cir.), *cert. denied*, 396 U.S. 895 (1969); *Nasser* v. *Isthmian Lines*, 331 F.2d 124, 127 (2 Cir. 1964). Rule (41b) provides in relevant part that:

> "Unless the court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule, other than a dismissal for lack of jurisdiction, for improper venue, or for failure to join a party under Rule 19, operates as an adjudication upon the merits."

The order and judgment dismissing the *White* action were not stated to be without prejudice. A strict application of Rule 41(b) would seem to require a holding that the dismissal of the *White* action operated as an adjudication upon the merits and hence as a bar to the present derivative suit. Indeed, the Supreme Court has made it more than clear in dicta that dismissals coming within the literal terms of Rule 41(b) generally do have *res judicata* effect. *Costello* v. *United States*, 365 U.S. 265, 286 (1961). Moreover, we have held that a dismissal pursuant to Rule 37 for failure

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answering the interrogatories by arguing that it was reasonable for them to wait for the First Circuit's decision in *Moses* before framing their answers to the interrogatories.

[4] There is nothing to the contrary in *Societe Internationale Pour Participations Industrielles et Commerciales, S.A.* v. *Rogers*, 357 U.S. 197, 207 (1958). There the Court merely indicated that the standards for granting or denying a motion to dismiss for failure to comply with discovery orders are governed by Rule 37, not Rule 41(b). That opinion did not suggest, however, that the effect of a Rule 37 dismissal was not to be determined by Rule 41.

to answer interrogatories is an adjudication upon the merits and bars an identical cause of action asserted in a subsequent suit. *Nasser* v. *Isthmian Lines, supra,* 331 F.2d at 128. *Nasser,* however, was neither a class action or a stockholder's derivative action. Rather, *Nasser* involved a plaintiff asserting a cause of action which belonged solely to him as an individual. Papilsky strongly urges that a different result is required where the plaintiff is a stockholder suing on behalf of a corporation.

The district court agreed with Papilsky and refused to accord *res judicata* effect to the *White* action. The court stated:

> "The derivative suit contains two claims: (1) a claim by the corporation in which plaintiff is a stockholder and (2) a claim by the stockholder against his corporation for its failure to enforce the claim belonging to it ((1) above)." 333 F.Supp. at 1087.

While conceding that Rule 41(b) applies to dismissals under Rule 37, the court concluded that the dismissal of the *White* action barred only the claim of the *White* plaintiffs against Affiliated, and not Affiliated's cause of action against the defendants.

III.

While we agree with the district court's holding that the judgment in the *White* action is not binding on nonparty stockholders, we do so without accepting the court's analysis of the nature of a stockholder's derivative action.

A stockholder's derivative action is a suit to enforce a corporate cause of action against officers, directors or third parties. Such an action consists of only one claim—the corporate claim against the alleged wrongdoers. The alleged injury inflicted upon the corporation is regarded as

affecting only the corporation. The fact that the injury may indirectly harm a stockholder by diminishing the value of his corporate shares does not bestow upon him a right to sue on his own behalf to recover damages. *Kauffman* v. *Dreyfus Fund, Inc.*, 434 F.2d 727, 732 (3 Cir. 1970), *cert. denied*, 401 U.S. 974 (1971); *Hodge* v. *Meyer*, 252 Fed. 479, 483 (2 Cir.), *cert. denied*, 248 U.S. 565 (1918). See also McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit*, 46 Yale L.J. 421, 421 n. 2 (1936). Rather, assuming that a stockholder has satisfied the prerequisites of Fed. R. Civ. P. 23.1, he merely has a right to bring a derivative action on behalf of the corporation. As Justice Frankfurter stated in his dissenting opinion in *Smith* v. *Sperling*, 354 U.S. 91, 99 (1957):

> "The contrasting difference between a stockholder's suit for his corporation and a suit by him against it, is crucial. In the former, he has no claim of his own; he merely has a personal controversy with his corporation regarding the business wisdom or legal basis for the latter's assertion of a claim against third parties. Whatever money or property is to be recovered would go to the corporation, not a fraction of it to the stockholder. When such a suit is entertained, the stockholder is in effect allowed to conscript the corporation as a complainant on a claim that the corporation, in the exercise of what it asserts to be its uncoerced discretion, is unwilling to initiate."

Accord, *Kauffman* v. *Dreyfus Fund, Inc., supra*, 434 F.2d at 734-35. This right "to conscript the corporation as a complainant" cannot be equated with a cause of action against the corporation. A corporation cannot be held liable to a plaintiff-stockholder for failing to prosecute an al-

legedly valid corporate claim. Rather than initiating a cause of action against the corporation, the plaintiff-stockholder in a derivative suit is seeking to enforce, for the benefit of the corporation, a corporate claim which the corporation, for whatever reason, is unwilling to prosecute.

The district court's reliance on *Ross* v. *Bernhard*, 396 U.S. 531 (1970), for the proposition that a stockholder's derivative suit consists of two claims, is misplaced. There the Court merely recognized "the dual nature of the stockholder's action: first, the plaintiff's right to sue on behalf of the corporation and, second, the merits of the corporation's claim itself." 396 U.S. at 534-35. There is nothing in the opinion which elevates a stockholder's right to sue on behalf of the corporation to the level of a stockholder's claim against the corporation for failure to enforce a corporate cause of action. To the contrary, the Court's analysis of the nature of a stockholder's derivative suit is entirely consistent with our conclusion that such an action consists of only one claim—the corporate claim:

> "The claim pressed by the stockholder against directors or third parties 'is not his own but the corporation's.' *Koster* v. *Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 522 (1947). The corporation is a necessary party to the action; without it the case cannot proceed. Although named a defendant, it is the real party in interest, the stockholder being at best the nominal plaintiff. The proceeds of the action belong to the corporation and it is bound by the result of the suit. The heart of the action is the corporate claim." 396 U.S. at 538-39.

Accordingly, the district court's dismissal of the *White* action encompassed the corporate claim which a different stockholder is now asserting in the present derivative suit. The question which we must now consider is whether the

judgment in the *White* action should be given *res judicata* effect, even though notice of the proposed dismissal of the *White* action was not given to nonparty stockholders.

We hold that, when notice of a proposed dismissal of a stockholder's derivative suit for failure to answer interrogatories is not given to nonparty stockholders, the judgment of dismissal does not bar an identical cause of action asserted by a different stockholder in a subsequent derivative suit. As previously indicated, the order and judgment dismissing the *White* action were not stated to be without prejudice and hence the effect of the dismissal normally would be to preclude the initiation of a suit based on the same cause of action. See *Costello* v. *United States, supra,* 365 U.S. at 286; *Nasser* v. *Isthmian Lines, supra,* 331 F.2d at 128. Accordingly, our decision in this case carves out an exception to the general principles of Rule 41(b) for derivative suits dismissed for failure to answer interrogatories.[5] While we have been unable to find a case precisely

[5] Appellants contend that *Saylor* v. *Lindsley,* 391 F.2d 965 (2 Cir. 1968), indicated that no such exception should be created. That case involved the effect to be given a derivative action dismissed for failure to post a security bond. This Court refused to accord *res judicata* effect to the judgment of dismissal, as the stockholder had merely failed to satisfy a precondition for bringing the suit. 391 F.2d at 969. Cf. *Costello* v. *United States, supra,* 365 U.S. at 286. In dictum, the Court did say:

> "Although neglect to prosecute would normally provide an appropriate occasion for the invocation of Rule 41(b). . . ." 391 F.2d at 969.

This dictum is not necessarily inconsistent with our decision today. We agree that dismissal for failure to prosecute, when not stated to be without prejudice, would normally preclude the bringing of another suit based on the same cause of action. Assuming that a dismissal for failure to prosecute should be treated the same as a dismissal for failure to answer interrogatories, our decision simply carves out an exception to the general rule in the case of a stockholder's derivative suit.

in point,[6] principles enunciated in analogous situations do lend support to our holding. In short, our decision today marks no new departure in the law.

Courts traditionally have exhibited understandable caution in according *res judicata* effect to a prior derivative action in which the present plaintiff-stockholder did not participate. Such caution is warranted in the context of derivative actions in view of the fact that the plaintiff-stockholder is affecting a right which belongs to the corporation. To discourage the plaintiff from sacrificing the corporate cause of action to further his own self interest, notice of proposed dismissals to nonparty stockholders is

[6] The able District Judge below indicated that he was "inclined to believe that notice to shareholders was required in connection with dismissal of the White action." 333 F. Supp. at 1086-87. However, because of his view of the nature of a stockholder's derivative suit, he assumed for the purposes of his decision that notice was not required.

In an analogous situation, the Eighth Circuit has held that notice of a proposed dismissal of a class action for lack of prosecution was not required "under the circumstances [t]here presented." *Partridge* v. *St. Louis Joint Stock Land Bank*, 130 F. 2d 281, 286 (8 Cir. 1942). The circumstances of that case were unusual, as the suit had been pending for nine years and no other members of the class had sought to intervene. Moreover, the *Partridge* decision said nothing about the effect to be given the dismissal in the event a subsequent suit were brought by a diffrent member of the class. Furthermore, the *Partridge* decision has met with critical comment:

> "This result can be criticized, however, since a failure to prosecute may reflect the fact that the representatives have lost interest in the suit because their own goals have been satisfied or for a number of reasons unrelated to the merits of the action or the rights of the other class members. Should this be the case, the representatives might refuse to pursue the action and not seek the court's approval of a dismissal, thereby intentionally or unintentionally evading the safeguards provided by subdivision (e) [notice and court approval]." 7A Wright & Miller, Federal Practice and Procedure 236 (1972).

required in a variety of situations. Where notice is a prerequisite to a dismissal of a derivative action, a judgment of dismissal will not be accorded *res judicata* effect unless such notice was given. *Winkelman* v. *General Motors Corp.*, 39 F.Supp. 826, 831 (S.D.N.Y. 1940). *Cf. Smith* v. *Alleghany Corp.*, 394 F.2d 381, 391 (2 Cir.), *cert. denied*, 393 U.S. 939 (1968); *Stella* v. *Kaiser*, 218 F.2d 64, 65 (2 Cir. 1954), *cert. denied*, 350 U.S. 835 (1955).

In general, notice of a proposed dismissal of a derivative suit must be given to nonparty stockholders when the corporate claim has not been adjudicated upon the merits. Fed. R. Civ. P. 23.1. Rule 23.1 provides in relevant part that a stockholder's derivative action "shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs."[7] The notice requirements of Rule 23.1 have been construed to apply to more than just dismissals of derivative suits following settlements. It is clear, for example, that voluntary dismissals under Fed. R. Civ. P. 41(a)(1) are within the scope of the notice requirements of Rule 23.1.[8] 3B Moore's Federal Pratice ¶23.1.24[2]

[7] Prior to 1966, the last sentence of Rule 23.1, which is quoted above, was covered by Rule 23(c). When stockholders' derivative suits were accorded separate treatment by the 1966 amendment, the notice and court approval prerequisites for derivative actions were preserved unchanged in Rule 23.1. Thus, cases involving derivative suits decided prior to 1966 are controlling for the purposes of applying the notice requirements of Rule 23.1. See 7A Wright & Miller, Federal Practice and Procedure 427 (1972).

[8] As Professor Moore writes:

> "Although voluntary dismissal by the plaintiff or by stipulation under Rule 41(a)(1) is expressly made subject to the provisions of Rule 23(e), and Rule 41(a)(1) fails to make a comparable exception for Rule 23.1 and Rule 23.2, this is

(1969); 7A Wright & Miller, Federal Practice and Procedure 435 (1972). Moreover, in order to prevent simple evasion of the safeguards of the Rule 23.1 notice provisions, we have held that a plaintiff-stockholder's consent to the entry of summary judgment against him is analogous to a voluntary dismissal and triggers the notice requirements of Rule 23.1. *Certain-Teed Products Corp.* v. *Topping,* 171 F.2d 241, 243 (2 Cir. 1948). See also *Goldfarb* v. *Ehlers,* CCH Fed. Sec. L. Rptr. ¶93,382 (E.D.N.Y. 1972); *Brendle* v. *Smith,* 7 F.R.D. 119, 120 (S.D.N.Y. 1946); *Winkelman* v. *General Motors Corp., supra,* 39 F.Supp. at 830-31.

There are cogent reasons for requiring notice of proposed voluntary dismissals and settlements of derivative actions. Notice is essential in these situations to ensure that the dimissal of the derivative suit is in the best interests of the corporation and the absent stockholders. See *Norman* v. *McKee,* 431 F.2d 769, 774 (9 Cir. 1970), *cert. denied,* 401 U.S. 912 (1971); *Cohen* v. *Young,* 127 F.2d 721, 726 (6 Cir. 1942), *cert. denied,* 321 U.S. 778 (1944). More specifically, notice and court approval of settlements under Rule 23.1 discourage private settlements under which the plaintiff-stockholder and his attorney profit to the exclusion of the corporation and nonparty stockholders. See *Wolf* v. *Barkes,* 348 F.2d 994, 996 (2 Cir.), *cert. denied,* 382 U.S. 941 (1965); *Birnbaum* v. *Birrell,* 17 F.R.D. 409, 411 (S.D.N.Y. 1955); *Craftsman Finance & Mortgage Co., Inc.* v. *Brown,* 64 F.Supp. 168, 178 (S.D.N.Y. 1945). Without the requirements of notice and court approval, there would be a greater incentive for stockholders to bring strike suits,

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an inadvertent omission. The specific requirement in Rule 23.1 for notice and court approval controls over the generality of Rule 41(a)(1) and must be observed in cases where it applies." 3B Moore's Federal Practice ¶ 23.1.24[2] (1969).

and it would be easier for alleged wrongdoers to "buy off" the corporation's representative. Moreover, the notice provisions of Rule 23.1 have been interpreted to apply to a voluntary dismissal and to a dismissal following consent to the entry of summary judgment in order to prevent such dismissals from being a cloak for a collusive settlement between the plaintiff-stockholder and the defendants. See 7A Wright & Miller, Federal Practice and Procedure 435 (1972).

Aside from limiting the opportunities for collusion, there are persuasive reasons for requiring notice to nonparty stockholders of a proposed voluntary dismissal. Assuming that the plaintiff-stockholder is attempting to enforce a valid corporate claim, the Rule 23.1 safeguards will protect the corporation and absent stockholders from a plaintiff who becomes "fainthearted" prior to the completion of litigation and wishes to settle the derivative suit even though such a disposition would not be in the best interests of the corporation. See *Webster Eisenlohr, Inc.* v. *Kalodner*, 145 F.2d 316, 320 (3 Cir. 1944), *cert. denied*, 325 U.S. 867 (1945); *Marcus* v. *Textile Banking Co.*, 38 F.R.D. 185, 187 (S.D.N.Y. 1965). Similarly, notice to nonparty stockholders of voluntary dismissals protects against prejudice to the corporation from discontinuance of a derivative suit after the plaintiff-stockholder has already secured an advantage or when the statute of limitations precludes the institution of a new suit. See McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit*, 46 Yale L.J. 421, 428 (1936). In these situations, notice enables other stockholders to intervene to protect the corporate claim and to continue the litigation if that seems advisable.

The policy considerations which support requiring notice of a proposed voluntary dismissal are not applicable

when the corporate claim is dismissed after a hearing on the merits. Litigation upon the merits substantially reduces the opportunities for collusion between the plaintiff-stockholder and the defendants. A contest upon the merits is presumed to indicate that the plaintiff-stockholder vigorously prosecuted the claim on behalf of the corporation. Accordingly, the Rule 23.1 notice provisions do not apply to dismissals following litigation upon the merits. See *Daugherty* v. *Ball*, 43 F.R.D. 329, 335 (C.D. Calif. 1967); 3B Moore's Federal Pratice ¶23.1.24[2] (1969); 7A Wright & Miller, Federal Practice and Procedure 436 (1972). See also *Pelelas* v. *Caterpillar Tractor Co.*, 113 F.2d 629, 633 (7 Cir.), *cert. denied*, 311 U.S. 700 (1940) (class action); *Hutchinson* v. *Fidelity Inv. Ass'n.*, 106 F.2d 431, 436 (4 Cir. 1939) (class action); *Dolgow* v. *Anderson*, 53 F.R.D. 664, 690 (E.D.N.Y. 1971) *aff'd*, —— F.2d —— (2 Cir. 1972), slip op. 3615 (June 20, 1972) (class action). Even without notice, a dismissal after a hearing on the merits is a binding adjudication of the corporate claim and precludes nonparty stockholders from bringing a subsequent derivative suit based on the same cause of action. *Ratner* v. *Paramount Pictures, Inc.*, 6 F.R.D. 618, 619-20 (S.D.N.Y. 1942).

A dismissal for failure to answer interrogatories cannot accurately be characterized as either a voluntary dismissal or a dismissal following a hearing on the merits. True, it has some attributes of a dismissal following litigation upon the merits. The plaintiff-stockholder does oppose the dismissal.[9] Moreover, as there is no initial bar

[9] Of course, if the *White* plaintiffs had consented to the dismissal for failure to answer interrogatories, the dismissal would have been voluntary and notice clearly would have been required. See *Certain-Teed Products Corp.* v. *Topping*, *supra*, 171 F. 2d at 243; *Winkelman* v. *General Motors Corp.*, *supra*, 39 F. Supp. at 830-31. Here the *White* plaintiffs did not consent to the dismissal.

to reaching the merits, the defendants may be put to the inconvenience of preparing to defend on the merits. See *Costello* v. *United States, supra,* 365 U.S. at 286. Furthermore, dismissals for failure to answer interrogatories are based in part upon the presumption that the plaintiff's alleged cause of action is without merit. See *Hammond Packing Co.* v. *Arkansas,* 212 U.S. 322, 349-54 (1909). Nevertheless, on balance, we believe that dismissals of derivative suits for failure to answer interrogatories are more analogous to voluntary dismissals. Thus, if prior dismissals for failure to comply with discovery orders are to be given *res judicata* effect, notice of the proposed dismissal must be given to nonparty stockholders.

The policy considerations which compel the giving of notice prior to voluntary dismissals are equally applicable to dismissals for failure to answer interrogatories. Similar to the reasons for extending the notice provisions of Rule 23.1 to a dismissal following consent to the entry of summary judgment, a dismissal for failure to answer interrogatories could easily disguise a collusive settlement.[10] To permit dismissal without notice for failure to comply with a discovery order would provide a simple technique whereby fraudulent directors or officers could avoid future liability by having a complaint stockholder sue and withdraw at an appropriate moment. Moreover, notice of a proposed dismissal for failure to answer interrogatories will protect the corporation and absent stockholders from a plaintiff-stockholder who, for reasons unrelated to the

[10] We do not suggest that in the instant case there was any collusion between the *White* plaintiffs and the defendants. The district court specifically noted: "There is not the slightest suggestion of any impropriety in the motions to dismiss and in the dismissal of the White action; the Court at the time was fully advised in the premises." 333 F. Supp. at 1087.

merits of the corporate claim, chooses not to comply fully with a discovery order. For example, it must be remembered that a plaintiff-stockholder generally finances the prosecution of the derivative suit out of his own pocket and will not be reimbursed unless successful. Such a person may decide that the financial risk is too great to justify expending large sums of money to supply complete answers to interrogatories. Requiring notice under Rule 23.1 in these situations affords nonparty stockholders an opportunity to intervene to prosecute the suit to its completion.

Even aside from the Rule 23.1 notice provisions, there is an additional reason for our reluctance to accord *res judicata* effect to the judgment in the *White* action. If we were to apply the general principles of Rule 41(b) and hence to bar the present suit, a serious due process question would arise. The rationale for binding nonparty stockholders to a judgment in a derivative action is that a plaintiff-stockholder represented their interests in that litigation. If nonparty stockholders are to be conclusively bound by the results of an action prosecuted by a stockholder ostensibly representing their interests, however, fundamental considerations of fairness and justice demand that the representation be adequate. Cf. *Hansberry* v. *Lee*, 311 U.S. 32, 44-46 (1940). One of the principal criteria for adequacy of representation is that the representation must be of such character as to insure the vigorous prosecution of the claim. Cf. *Eisen* v. *Carlisle & Jacquelin*, 391 F.2d 555, 562-63 (2 Cir. 1968) (class action); *Fogel* v. *Wolfgang*, 47 F.R.D. 213, 216 (S.D.N.Y. 1969) (class action); *Dolgow* v. *Anderson*, 43 F.R.D. 472, 494 (E.D.N.Y. 1968), *rev'd on other grounds*, 438 F.2d 825 (2 Cir. 1970) (class action). As the court said in *Mersay* v. *First Re-*

public Corp. of America, 43 F.R.D. 465, 470 (S.D.N.Y. 1968) (class action):

> "[T]he primary criterion is the forthrightness and vigor with which the representative party can be expected to assert and defend the interests of the members of the class, so as to insure them due process."

The fact that the *White* action was dismissed for failure to answer interrogatories raises some doubt as to whether the *White* plaintiffs provided the type of representation necessary to satisfy the dictates of due process. The uncertainty about the adequacy of the representation is increased somewhat by the Special Master's conclusion that the *White* plaintiffs were "not serious in prosecuting this action . . ." and by the First Circuit's decision in *Moses* v. *Burgin, supra,* note 3, which held that claims similar to those asserted in the *White* action could constitute violations of the Investment Company Act of 1940. Since we hold that failure to give notice to nonparty stockholders precludes according *res judicata* effect to the *White* action, we do not have to decide whether the *White* plaintiffs failed to provide adequate representation.

Affirmed.

Previous Opinions in the Case on Issues not Relevant to the Petition

Denial of Petition for Writ of Certiorari

Supreme Court of the United States

OFFICE OF THE CLERK

WASHINGTON, D. C. 20543

JUDSON A. PARSONS, JR., ESQ.
Dewey, Ballantine, Bushby,
Palmer & Wood
140 Broadway
New York, N. Y. 10005

RE: BERNDT, ET AL. *v.* PAPILSKY,
No. 72-651,

Dear Sir:

The Court today denied the petition for a writ of certiorari in the above-entitled case.

Very truly yours,

MICHAEL RODAK, JR., *Clerk*

By ----------

HELEN TAYLOR, (MRS.)
Assistant Clerk

WILLIAM E. HAUDEK, ESQ.
Pomerantz, Levy, Haudek & Block
295 Madison Avenue
New York, N. Y. 10017